DRAFTING INTERNATIONAL CONTRACTS

An Analysis of Contract Clauses

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Transnational Publishers, Inc.
Ardsley, New York

CONTENTS

LIST OF ABBREVIATIONS

A.2d	Atlantic Series, Second Edition
A.C.	Law Reports, Appeal Cases
All E.R.	All England Law Reports
Am. J. Comp. L.	American Journal of Comparative Law
Ann.Fac.Dr.Liège	Annales de la Faculté de Droit de Liège
Arch. Phil. Dr.	Archives de Philosophie du Droit
BCLC	Butterworths Company Law Cases
Cah. Dr. Eur.	Cahiers de Droit Européen
Colum. J. Transnat'l L.	Columbia Journal of Transnational Law
Colum. L. Rev.	Columbia Law Review
Dall.	Recueil Dalloz
Dir. Comm. Intern.	Diritto del Commercio Internazionale
D.P.C.I.	Droit et pratique du commerce international
F.2d	Federal Reporter (Second Series)
FSR	Fleet Street Reports
Gaz. Pal.	Gazette du Palais
Int. Comp. L.Q.	The International and Comparative Law Quarterly
Journ. Business Law	Journal of Business Law [
Journ. Dr. Int.	Journal de Droit International
Journ. Int. Arb.	Journal of International Arbitration
Journ. Off.	Journal Officiel
Journ. Trib.	Journal des Tribunaux (Belgique)
Jur. Class. Pér.	Jurisclasseur Périodique
Lloyd's Rep.	Lloyd's Law Reports
Lloyd's Mar. Com. L.Q.	Lloyd's Maritime and Commercial Law Quarterly
LQR	Law Quarterly Review
Ned. Jurist. Blad	Nederlands Juristenblad
Nethel.Int. Law Rev.	Netherlands International Law Review
Northwestern Univ. Law Rev.	Northwestern University Law Review
Pas.	Pasicrisie belge
P&CR	Property and Compensation Reports
Q.B.	Queen's Bench
RabelsZ.	Zeitschrift für ausländisches und internationales Privatrecht

R.D.A.I./I.B.L.J.	Revue du droit des affaires internationales/ International Business Law Journal
Rec.	Recueil des arrêts de la Cour de Justice
Rechts.Weekbl.	Rechtskundig Weekblad
Rev. Arb.	Revue de l'arbitrage
Rev. Crit. dr. int. privé	Revue Critique de droit international privé
Rev. Crit. Jur. B.	Revue Critique de jurisprudence belge
Rev.Comm.Belg.	Revue de droit commercial belge
Rev. Dr. Immob.	Revue du droit immobilier
Rev. Dr. Int. Dr. Comp.	Revue de droit international et de roit comparé
Rev. Dr. McGill	Revue de droit McGill
Rev. Dr. Unif.	Revue de droit uniforme
Rev. Int. Dr. Comp.	Revue internationale de droit comparé
Rev. Rég. Dr.	Revue régionale de droit
Rev. Trim. Dr. Civ.	Revue trimestrielle de droit civil
Rev. Trim. Dr. Com.	Revue trimestrielle de droit commercial et de droit économique
Rev. Trim. Dr. Eur.	Revue trimestrielle de droit européen
R.I.W.	Recht der internationalen Wirtschaft
Southern Calif. Law Rev.	Southern Californian Law Review
TLR	Times Law Reports
T.P.R.	Tijdschrift voor Privaatrecht
Tulane J.Int'l Comp. L.	Tulane Journal of International and Comparative Law
Tulane Law Rev.	Tulane Law Review
U.S.	United States Supreme Court Reporter
Virginia Law Rev.	Virginia Law Review
Wayne L. Rev.	Wayne Law Review
WLR	Weekly Law Report

INTRODUCTION

The law of international contracts is a particularly rich field for research. This becomes obvious when one examines very closely how these contracts are drafted in practice.

A Working Group on International Contracts (hereafter also referred to as Working Group or Group) has been meeting since 1975 to conduct a systematic analysis of the main types of clauses appearing in international contracts. The Working Group uses large samples taken from the practical experience of its members. The Group is made up of corporate lawyers, members of the Bar and professors specializing in international trade transactions. Most participants come from France and Belgium, but other nations, for instance: Brazil, Egypt, England, Germany, Italy, the Netherlands, Poland, Spain, Switzerland and the United States,[1] are represented by assiduous members. The Group meets usually two or three times a year. For each new topic, abundant documentation is initially gathered to be discussed during several meetings. A draft report is then prepared and submitted to the Group before being finalized. All studies have been published, either in *Droit et Pratique du Commerce International,* or in the *International Trade Law Journal.*[2] From 1975 to 1992, the Group was chaired by Marcel Fontaine, before Filip De Ly took the chair.

Over the years, these reports have gradually covered the most sensitive clauses, offering a reasonably complete image of how an international contract is or should be drafted at the beginning of the 21st century. The present book would like to document this cooperative effort, by gathering and coordinating updated versions of the different reports published between 1975 and 2001.[3]

The first edition of this book was published in 1989.[4] In preparation for this book, earlier reports have again been submitted to a smaller com-

[1] A complete list of all participants since the Group's origins is given as an appendix.

[2] References to the original publications are given as an appendix.

[3] Two reports elaborated by the Group do not appear in the present volume, because they do not deal with general types of contractual clauses, but rather with a specific contract as a whole (cf. Aspects juridiques des contrats de compensation, *D.P.C.I.*, 1981, pp. 179–223) or with a clause specific to a type of contracts (cf. Les clauses de divorce dans les contrats de groupements d'entreprises internationaux, *I.B.L.J.*, 1995, pp. 279–315).

[4] M. Fontaine, *Droit des contrats internationaux—Analyse et rédaction de clauses,* Paris, F.E.C., 1989, 365 pp.

mittee, then to the whole Group. A large number of new clauses have been gathered and discussed on each single topic in order to achieve an adequate update of the working in actual practice.

The Group has worked on clauses drafted in different languages. Many of them are written in English, but some others in French, Spanish, German or Italian. They are quoted in their original versions, due to the difficulty of preparing absolutely reliable translations. The commentaries should enable the reader not familiar with some of these languages to grasp the meaning of the quotations.

The Group continues its work. As this book is being printed, the Group is engaged in the study of choice of law and dispute resolution clauses. There will certainly be material for a further edition in a few years.

The life of a contract begins at conception. The negotiating stage is not void of legal effects. In practice, during the lengthy negotiations that can be expected when dealing with important economic operations, the parties exchange preparatory documents, such as letters of intent and similar instruments. Their legal consequences are analyzed in the first chapter. When the contract is drafted, parties often feel the need to make different statements in "recitals": they introduce themselves by name and qualifications, state the purposes of the contract, list the main stages of the negotiation, etc. Such introductions are far from being without legal effects (Chapter 2). In addition, parties are often concerned with including some clauses that could help interpret the contract: definitions, entire agreement clauses, stipulations concerning the use of languages, modifications, waivers, partial avoidance, etc. (Chapter 3).

Once the contract is concluded, it has to be performed. One problem is to define the intensity of the obligations undertaken by the respective parties, especially when contractual clauses resort to "open" formulas: to exert one's *best efforts,* to act with *diligence,* to take *reasonable* care, etc. What could be the meaning of such common but imprecise expressions (Chapter 4)? A particularly sensitive obligation is that of keeping certain information confidential. The drafting of confidentiality clauses proves to be delicate (Chapter 5).

Several characteristic clauses deal with the risk of non-performance. An obligee will often attempt to determine in advance the amount of the damages due by the other party in case of breach, with an adequate *liquidated damages* clause, but such a clause may also be inspired by the obligor himself wishing to limit his liability (Chapter 6). Exemption and limitation of liability clauses come in a great variety (Chapter 7). Non-performance cannot always be imputable to the obligor, who may then find his exemption

in a *force majeure clause*; such clause, in international contracts, has very particular characteristics (Chapter 8). Sometimes, performance of a contract is not impossible, but it is seriously hindered by a change in circumstances that were originally present when the contract was executed. What is to happen to the contract in such situations, including its renegotiation, is the subject matter of *hardship clauses* (Chapter 9).

Other clauses provide for the adaptation of the contract when certain market conditions change and the competition is affected (*"English" clauses* and *most-favored customer clauses*), or grant a party the right of *first refusal* in case another operation takes place (Chapter 10). The rights and obligations deriving from the contract, and sometimes the contract itself, may be assigned. Certain clauses tend to provide for such operations, usually with a restrictive approach (Chapter 11).

The contract normally terminates when performance is complete, but other causes may lead to its premature ending. Such causes are often organized by clauses that can often be elaborate (Chapter 12). Finally, some *clauses survive the contract*, having effects that extend beyond the performance of the main obligations: warranties, confidentiality, non-competition clauses, etc. (Chapter 13).

This systematic analysis of the main clauses present in international contracts leads to a few concluding observations.

The publication of this book offers the opportunity to express gratitude. First of all, we thank the members of the Working Group on International Contracts, without whom this would not have been possible. The different studies were written by each of us respectively, but we simply present and expand, at our risk, the results of the fascinating discussions to which all members have contributed, on the basis of the invaluable documentation and the treasure of experience they have provided. We also want to thank them, perhaps above all, for the friendly atmosphere that permeates all our meetings, and which has contributed so much to the success of the project.

This English edition is the result of many efforts. Our special gratitude goes to the *International Business Law Journal* (Paris), as well to Paul Ellington, our late friend, and to Juan Rodrigues, who provided English translations of earlier versions of different chapters. The whole manuscript was edited with great care and competence by Barbara Jungers, whom we warmly thank for her extremely appropriate corrections and suggestions.

Professor Henry Lesguillons, this tireless and imaginative promoter, originally asked that one of us create and chair this Group. He never

ceased to provide us with help and encouragement. He deserves our deep gratitude.

Finally, this book owes much to the late Professor Charley del Marmol. Back in the 1950s, he conceived the idea to organize these productive meetings between corporate counsel and law professors, within the *"Commission Droit et Vie des Affaires"* of Liège University in Belgium; he was the proponent of a less litigious perception of the law, of a positive approach aimed at preventing disputes through fair and well drafted contracts. Such spirit inspires the work of the Group, as well as this book.

Marcel Fontaine and Filip De Ly

September 2005

CHAPTER 1
LETTERS OF INTENT

I. INTRODUCTION

Before its conclusion, a future contract may produce particular legal effects. The negotiations that precede the parties' agreement may give rise to obligations and, by engaging in those negotiations, potential partners may lose part of their freedom of action and may have to comply with certain behavioral standards.

This is true, in particular, when the contract relates to a complex and wide-reaching operation, for which the negotiations or the performance may take months or even years and will require the cooperation of several enterprises. Consider, for example, complex mergers and acquisition contracts, agreements relating to the turn-key construction of a factory or to integrated production of civil or military aircraft, the exploration or extraction of natural resources, long-term supply contracts for primary materials or the transfer, exchange or joint implementation of new technology.

The legal structure covering such operations is necessarily very intricate. Sometimes there are a number of inter-dependent contracts with numerous and often complex clauses seeking to join provisions that are essentially "technical" with others more specifically "legal."

The negotiations of such contracts are long and difficult. Between the initial definition of the common objectives and the signing of the final agreements, there is a slow work process: preliminary studies, obtaining the necessary assistance from third parties (e.g., financing and insurance), applying for governmental permits that will eventually be required and ultimately refining the details relative to the various aspects of the agreement between the parties (e.g., specifications, periods for completion and delivery, determination of prices, clauses providing for variations and supervening events, guarantees of performance, arbitration). Such negotiations and the various stages involved, may take years. Not infrequently, the discussions continue after the start of performance of the contract, when the urgency of the project drives the parties to proceed with operations before the contractual documents are fully completed.

During the prolonged gestation of their agreements, the negotiators often feel the need to create a series of preparatory documents. At the start, such documents set out the purpose and scope of the discussions to

come, and they spell out procedural aspects. As the discussions proceed, their results are recorded. Certain basic agreements may be accepted, while specific details remain to be determined.

Sometimes, such documents are intended to inform third parties whose involvement is sought. At other times, it is such third parties who, upon the request of one of the principal parties, provide written assurance of their eventual involvement, so that this may be known to the other principal party.

Any such preparatory documents are frequently titled letter of intent or memorandum of understanding, though many other expressions are used (protocol, letter of understanding, agreement in principle, heads of agreement, etc.). The frequency of their use in practice has led to the common use of their abbreviations such as "L/I" (letter of intent), "MoU" (memorandum of understanding) or LoU (letter of understanding). This chapter will investigate the legal effect of such documents and offer advice to potential drafters.

For this purpose, the expression "letter of intent" will generally be used hereinafter to designate any kind of pre-contractual document[1] by which one or both parties intend to organize the negotiations and execution of the contract.[2] The notion of "letter of intent" has the advantage of reflect-

[1] A document will be established in most cases for evidentiary purposes, but one can also consider purely verbal expressions of intent.

[2] The subject of letters of intent was very novel when the original report was published in 1977. Since then, a vast literature has developed. See, for instance, the proceedings of a colloquium held in Tours on negotiating international contracts, partly devoted to letters of intent, *D.P.C.I.*, 1979, pp. 49–69 as well as U. Draetta, *Il diritto dei contratti internazionali. La formazione dei contratti*, Padova, 1984, pp. 47–80; J. Cedras, L'obligation de négocier, *Rev. Trim. Dr. Com.*, 1985, pp. 265–290; U. Draetta, Gli usi del commercio internazionale nella formazione di contratti internazionali, in *Gli usi del commercio internazionale nella negoziazione ed esecuzione dei contratti internazionali*, Milan, 1985, pp. 37–52; F. T'Kint, Négociation et conclusion du contrat, in *Les obligations contractuelles*, Jeune Barreau (ed.), Brussels, 1984, No. 36–38bis (Les "accords de principe"); G. Schrans, De progressieve totstandkoming der contracten, *T.P.R.*, 1984, pp. 1–32; Ph. Marchandise, La libre négociation—Droits et obligations des négociateurs, *Journ. Trib.* (Brussels), 1987, pp. 624–625, updated in Le juriste dans la négociation, Brussels, Bruylant, 1998, pp. 3–25; L. Rozes, Projets et accords de principe, *Rev. Trim. Dr. Com.*, 1998, pp. 501–510; Siebourg, *Der Letter of Intent*, thesis, Bonn, 1979; *Formation of contracts and precontractual liability*, Paris, ICC Publishing, 1990, 354 pp.; *Precontractual liability*, Reports to the XIIIth Congress International Academy of Comparative Law, E.H. Hondius (ed.), Deventer, Kluwer, 1990, 376 pp.; U. Draetta & R. Lake, *Letters of intent and other precontractual documents*, 2nd ed., Salem, N.H., Butterworths, 1994, 330 pp.; J.M. Loncle & J.Y. Trochon, Pratique des négociations dans les rapprochements d'entreprises, Paris, EFE, 1997, 85–101; M. Furmston, T. Norisada & J. Poole, *Contract formation and letters of intent*, Chichester, Wiley, 1998, 322 pp.; N. Herzog, *Der Vorvertrag im schweizerischen und deutschen Schuldrecht*, Zurich, Schulthess, 1999, 240 pp.; G. Capecchi, Il valore giuridico delle let-

ing a wide and encompassing variety of pre-contractual documents. The discussions held and analyses reached in the Working Group made clear that, in practice, all the above expressions are used in an inter-changeable manner and have no precise significance. However, some believe that "MoUs" and heads of agreement belong more specifically to the category of letters of intent stating the results of negotiations already achieved, which need not be discussed again.[3]

The legal nature of letters of intent remains unclear. It appears that often the writers of such letters believe that they incur no obligations, although there sometimes harbor the thought that they might obtain a commitment from the other party. Notwithstanding the enormous variety of situations and formulae one may encounter,[4] one gains the impression that certain letters of intent or certain clauses contained in such letters, do create, at that stage, certain legal obligations on the part of their signatories. The principal difficulty regarding the characterization of letters of intent lays in the fact that, whatever the applicable law, the phenomenon of letters of intent has hardly received any notice from the classic rules of law on the formation of contracts. The established pattern of law, as well as international uniform law instruments, have been built from observation of very simple contracts for everyday life, contracts whose formation is, for the most part, immediate. Certainly, legal science has developed certain refinements, such as the rules applicable to contracts formed by correspondence, or to promises to contract, or the doctrine of "*culpa in contrahendo*," but it seemed remarkably ill-prepared in the face of the many vicissitudes of even slightly complex negotiations.

More recently, letters of intent, agreements in principle and similar documents have gradually found a place in legal analyses of pre-contractual negotiations, even appearing in some classical treatises. Case law also

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tere di intenti, *Dir. Comm. Int.*, 2001, pp. 383–394; J.M. Mousseron, M. Guibal & D. Mainguy, *L'avant-contrat*, Paris, F. Lefebvre, 2001, 379 pp.; *Good faith in European Contract Law*, R. Zimmermann & S. Whittaker, Cambridge University Press, 2000, pp. 236–257; L. Vandomme, La négociation des contrats internationaux, *I.B.L.J.*, 2003, pp. 487–501; A. Berg, Promises to Negotiate in Good Faith, *Law Quarterly Review*, July 2003, pp. 357–363; G. Capecchi, Nature and enforceability of a letter of intent under Italian Law, *I.B.L.J.*, 2004, pp. 151–160.

[3] R. Schlosser, Les lettres d'intention: portée et sanction des accords précontractuels, in *Responsabilité civile et assurance, Etudes en l'honneur de Baptiste Rusconi*, Lausanne, Editions bis et ter, 2000, pp. 347–348. An analogy can be drawn to "Term-sheets" used in the financial sector to summarise the main terms of a transaction (e.g., a loan agreement) in a few pages. In bank practice, "Term-sheets" are generally considered as indicative but non-binding.

[4] This diversity is especially demonstrated in a Dutch book: W.M.S. Schut, *Letters of Intent*, Tjeenk Willink, 1986, 108 pp.

produced some remarkable decisions where judges took the opportunity to state some governing principles.[5]

However, the legal analysis of letters of intent still means, in large measure, the exploration of new territory. It involves an exercise in reflection and imagination based on general principles,[6] complicated by the fact that these principles vary from one legal system to the next.[7] The elements of the answer that will be proposed in this book must be viewed critically; they only constitute a first sketch of a legal edifice where much remains to be done.

What *method* was followed by the Working Group on International Contracts in the study of letters of intent?

A substantial collection of sample documents was assembled: more than 100 letters of intent or analogous documents were the subject of discussion and analysis.[8] To avoid pre-judging the result of our discussions, all documents created at whatever stage in negotiations and appearing to

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[5] Case law remains scarce. A few decisions will be analyzed further in this chapter. Another illustration is the S.M.E. case in Italy. An agreement was concluded in 1985 between the I.R.I. and Buitoni concerning the transfer to the latter of 51 percent of S.M.E. shares. This agreement was not implemented and a Rome tribunal regarded it as the mere expression of an intent to negotiate, not to conclude a contract (cf. U. Draetta, Criteri redazionali di littere di intento alla luce dei casi Pennzoil e SME, *Dir. Comm. Intern.*, 1987, pp. 249–250. The text of the agreement is reproduced at pp. 270–272).

[6] For a thorough analysis demonstrating that letters of intent avoid the "all or nothing" of the traditional law of contract formation and are instruments of risk management, see M. Lutter, *Der Letter of Intent*, 3rd ed., Cologne, C. Heymanns Verlag, 1998, 215 pp.

[7] For comparative studies, see the notes published with the black letter provisions and comments of the *Principles of European Contract Law*, O. Lando & H. Beale (eds.), The Hague, Kluwer Law International, 2000, pp. 191–193; *Good Faith and Fault in Contract Law*, J. Beatson & D. Friedman (eds.), Oxford, Clarendon, 1995, 531 pp.; J.W. Carter & M. Furmston, Good faith and fairness in the negotiation of contracts, 8 *Journ. of Contract Law*, 1995, pp. 1 and 93–119. Also see a study of American, English, French and German law which points out the differences and shades separating those four systems on two levels: determining the moment when a contract is deemed to be concluded and the conditions under which pre contractual liability may appear (R.B. Lake, Letters of Intent: A Comparative Examination Under English, U.S., French and West German Law, 18 *Geo. Wash. J. of Int. Law and Econ.*, (1984), pp. 331–354). Further references are K. Zweigert & H. Kötz, *An Introduction to Comparative Law*, 3rd ed., 1998, pp. 356–364; Centre de droit des obligations de l'Université catholique de Louvain, *Le processus de formation du contrat*, M. Fontaine (ed.), Brussels, Bruylant and Paris, L.G.D.J., 2002, 920 pp. About letters of intent in respect to the *lex mercatoria*, see F. Osman, *Les principes généraux de la lex mercatoria*, Paris, L.G.D.J., 1992, pp. 50–83, who also considers the competence of international arbitrators in disputes concerning liability for breach of negotiations.

[8] Other illustrations of letters of intent are available in M. Lutter, *op. cit.*, pp. 161–198; R. Lake & U. Draetta, *op. cit.*, pp. 263–304.

constitute some part of the progressive elaboration of the final contract were brought together, whatever characterization the parties might have given them.

The Working Group then sorted these documents into two categories: firstly, those that could be classified into some known legal category (such as offers to contract, final contracts—appearances to the contrary notwithstanding—and contracts subject to a condition precedent) and secondly, true letters of intent, the real subject of our study. Guided by the explanations of those members of the Group who had provided the documents and had been personally involved in the negotiations in question, the Group then looked into the circumstances in which such letters were drafted, into their intended purposes, into the legal effect that one could attribute to them and into the guidance they could give for the conduct of negotiations.

The discussion was complicated by the fact that different analyses were possible depending on which law was applicable. The Group members conducted its discussions, for the most part, looking to French and Belgian law. We have, however, also attempted to establish the principal elements of analysis according to English law. The following pages will also make reference to other legal systems, in particular to American, Dutch, German, Italian and Swiss law, as well as to uniform law. The results of our discussions are presented in three sections.

To illustrate a variety of positive situations, the assembled documentation will first be presented in the form of various cases. The second section will try to formulate a theoretical synthesis of the nature and legal effect of letters of intent.

In conclusion, this report will offer practical recommendations to negotiators.

II. LETTERS OF INTENT: STUDY OF CASES

Twenty-six letters of intent extracted from our files will be the object of case studies. They typify the principal kinds of situations as identified by the Group. Brief commentaries will follow each case.

It is not rare to encounter letters of intent of up to ten pages and the excerpts given may not always fully reveal the context and the nature of those letters.[9]

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[9] The length of most of the letters of intent examined by the Group prevents us from presenting these examples in full. We will try, nevertheless, to provide as precise a description as possible, often with quotations of the most typical passages.

A. First Group: Definitive Contracts, With Particular Variations

The first group of examples discussed gives an initial appearance of vague and ambiguous language, tending against the existence of a perfect *consensus ad idem*, which the commentator must therefore bring out. We have also included, in the first group, two provisions that frequently encumber agreements that are otherwise definitive, i.e., conditions precedent and entry into force clauses.

Example 1—Acceptance of an Offer

Presentation: A letter entitled "lettre de commande" ("order form") is sent by a Minister to a Public Works Construction Company. It says:

> "Nous avons l'honneur de vous informer que vous êtes déclarés adjudicataires des marchés . . . relatifs à la construction, la fourniture, le montage, les essais et la mise en service de . . . L'adjudication est faite sur la base des prescriptions et des spécifications contenues dans les documents de l'appel d'offres, à savoir . . . , et aux conditions de votre offre du . . . , modifiée et mise à jour conformément au texte du procès-verbal de la réunion du. . . ."

The letter then repeats the details of the agreed prices before setting out the financial terms. It ends as follows:

> "Nous vous prions de nous faire parvenir dans un délai de quinze jours un accusé de réception, dûment signé et daté, pour acceptation sans réserves, de la présente commande."

Commentary: This letter certainly appears to constitute the acceptance of an offer, that is to say, the event that completes the formation of a definitive contract. Negotiations have taken place resulting in a final offer on the part of the offeror, to which precise reference has been made. The "order form" simply accepts this offer. There is, however, reason to doubt: the letter requires an acknowledgement of receipt "in order to provide an unqualified acceptance." Perhaps this is an attempt to transform into an offer what is already an acceptance, in order to postpone the formation of the contract; such an attempt, inconsistent with the facts, is ineffective. More simply, the author of the letter presumably wishes to have complete reassurance as to the terms of the transaction as they have been shaped during the negotiations.

Example 2—Letter of Comfort

Presentation: Company F accepts a loan from a bank. The bank asks for and obtains from company M, which owns the majority of the shares in F, the issuance of a letter as follows:

"Nous déclarons par la présente avoir parfaite connaissance des clauses et conditions d'ouverture de crédit conclues entre F et votre banque. Nous vous confirmons notre intention de conserver notre influence au sein de F et de veiller, par tous moyens appropriés, à ce que la situation financière de cette société lui permette de faire honneur à ces engagements qu'elle assume vis-à-vis de votre banque. Il va de soi que nous vous informerions au cas où notre point de vue à ce propos devrait se modifier."

Commentary: This is a document commonly called "letter of comfort" (in French the expression *lettre de patronage* is also used), by which a parent company shows, for the benefit of a party contracting with its subsidiary, its intention to maintain its control and support.[10] In the experience of several members of the Group, the deliberately vague description of the undertakings merely shows concern that these undertakings not be mentioned in the accounts of the parent company, but does not exclude that obligations are assumed. But, if so, what are the status and scope of any such obligations? The parent company does not, strictly speaking, guarantee a precise debt, but it does warrant, in a general way, the solvency of its subsidiary. The undertaking is certainly contractual; even if the "letter of comfort" is expressed in unilateral form, one may conclude that it has been the subject of the acceptance, at least tacitly, of its addressee, especially as the latter has, in most cases, requested the letter. What can we make of the last phrase in the letter? Some think that such a notification of change of attitude can only, in good faith, be given after an appropriate period of notice.

The foregoing analysis as to the effect of a "letter of comfort"[11] underlines an important principle of interpretation: the wording used by the parties is inconclusive, if it is inconsistent with the facts.[12]

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[10] See, e.g., J. Terray, La lettre de confort, *Banque*, 1980, pp. 329–338; Fac. de Droit de Namur & Feduci, *Les lettres de patronage*, Namur and Paris, 1984, 434 pp.; U. Dractta, La lettere di patronage nella prassi del commercio internazionale, *Diritto comunitario e degli scambi internazionali*, 1985, pp. 55–64; Chr. Bright & S. Bright, Beware the Letter of Comfort, *New Law J.*, 1988, pp. 365–367.

[11] In France, the *déclaration de patronage* has been the subject of an Opinion from the President of the Association of Banks, according to which, since it constitutes "a moral undertaking to ensure a satisfactory conclusion to the loan," it should be considered "as providing in practical terms security comparable to a guarantee," at least when it is issued by a company of repute. In the view of the Group, it goes further: one can discern in it a truly legal obligation. The text of this Opinion appears in the *Bulletin de la Caisse Nationale des Marchés de l'Etat*, 1975 No. 68 green pages 85–88 with a commentary that purports to deal with letters of intent in general, but, in fact, only deals with *déclarations de patronage*. The Opinion is further considered by C. Gavalda & J. Stoufflet in their study in *Semaine Juridique*, 1976, 1 No. 2301; in this study there are several interesting suggestions towards further precision of the legal nature of the *déclaration de patronage* according to the circumstances (in particular where the concept of natural obligation is concerned).

[12] Guarantees offered by a parent company to the party contracting with its sub-

Such documents must be distinguished from what will be characterized as specific letters of intent (see Section II.B). Letters of comfort are a form of personal security used in practice, with variable legal effects, while specific letters of intent are documents relating to pre-contractual negotiations between parties and to the progressive formation of the contract. So far as they give assurance of financial support of a mother company or a credit institution, letters of comfort share with some letters of intent the vagueness in expressing their legal effect; they are also often issued in order to facilitate negotiation between the supported company and a third party. However, a letter of comfort has its own finality; it is not part of the series of documents that will successively appear during the course of a negotiation. From the terminological point of view, it would be advisable to distinguish letters of comfort from "letters of intent," but the confusion remains widespread, at least in France.[13]

Example 3—Contract to Be Drafted

Presentation: A letter confirms with precision its author's agreement with the various elements of the offer and ends with the phrase:

> "Nous demandons à notre ingénieur-conseil de prendre contact avec vous, dans les meilleurs délais, en vue de la mise au point des documents définitifs des marchés."

As in Example 1, we find ourselves with the acceptance of an offer, that is to say, with the firm conclusion of the contract. Does the last phrase introduce doubts? Certainly not. Here it is only a question of drawing up the contract document, an operation that, in many legal systems, is without effect on the formation of the contract. But this example allows us to draw attention to the fact that many negotiators, not being legally qualified, wrongly imagine that nothing is truly concluded so long as a contract in full and due form has not been drawn up and signed, and that everything before this only expresses intent, even if the parties are fully determined to

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sidiary can be expressed much more precisely, e.g., in the form of a working capital agreement. This is a contract bearing the signatures of the parent company and the other contracting party by which the former, generally speaking, certifies the exactness of the financial situation of its subsidiary, undertakes to maintain its shareholding and guarantees the due performance of its obligations by the subsidiary. In such cases the agreement is quite unambiguous.

[13] Cf., e.g., B. Oppetit, L'engagement d'honneur, *Dall.*, 1979, Chr., pp. 109–110; M. De Vita, La jurisprudence en matière de lettres d'intention. Etude analytique, *Gaz. Pal.*, 1987, pp. 667–670; Cass. fr., 21 déc. 1987, *Jur. Cl. Pér.*, 1988, No. 21113, concl. M. Montanier, *Dall.*, 1989, J, 112, note J.P. Brill; X. Barré, *La lettre d'intention*, Paris, Economica, 1995, 410 pp.

proceed. Sometimes negotiators are aware that the agreement is complete, but wish to protect the susceptibilities of their legal advisers appointed to draw up the contract documents. This misconception, or this courtesy, is at the origin of a certain number of documents being called letters of intent. Although they are not a final evidential document, these letters produce full agreement of the parties with the terms of their contract, and, in spite of the semantics, they must be considered the final contract.

This situation is to be distinguished from cases where negotiators were only authorized to negotiate, not to conclude the contract. In these scenarios, no real meeting of the minds can occur prior to the participation of the legally authorized persons. The conclusion of the contract may then coincide with the signature of the evidentiary document (see Example 19 below).

Example 4—Contract to Be Drafted

Presentation: A department of a Ministry writes to a joint venture company:

> "This letter is to notify you of the Ministry's intent to award your firm the project for. . . ."

Then follow detailed references to the preceding documents, which led to the agreement of the parties with the terms of their transaction. The letter finishes with the formula:

> "Considering this as a letter of intent to start your preparation for commencing the works, we request you to delegate an authorized representative to sign the contract documents which are now being prepared; and to submit the contract final guarantee in accordance with the provisions of the Contract Documents."

Commentary: As in Example 3, this is probably the acceptance giving birth to a final contract, only the completion of the contract documents remains. The addressee of the letter is already invited to provide the guarantee envisaged in the contract. Some doubt can, however, arise from the fact that there is only mention of the intention of the Ministry, and that the document is entitled Letter of Intent. The terms used are not conclusive, if the context reveals a different situation (cf. Example 2). The intention of the Minister is equivalent to consent, and this self-styled letter of intent constitutes the final acceptance of the contract. The solution would be different if the applicable law made signature of the contractual documents an essential pre-condition to the binding of the public authorities, or if a problem of authority, as mentioned in the preceding example, arose.

Example 5—Declaration of Final Agreement, Temporary Evidential Document, Arbitration Clause

Presentation: One company writes to another in order to:

> "confirmer les agréables entretiens . . . au cours desquels ont été négociées diverses conventions,"

agreements then listed and the letter continues:

> "Il nous reste à matérialiser par divers contrats les modalités définitives de nos accords qui forment un tout, et nous attendons vos propositions de textes telles qu'elles résulteront de l'avant-projet que nous vous avons remis et des divers documents déjà échangés. Cependant, ainsi qu'il a été convenu de commun accord, la présente lettre constitue notre accord sur les conditions essentielles des contrats restant à spécifier, et de part et d'autre, nous sommes définitivement engagés et passons dès à présent à l'exécution, nous, en vous faisant effectuer les premiers paiements et vous, en commençant vos études."

Then follows a reminder of the principal elements of the agreements as reached. Next,

> "les divers documents échangés au cours de nos entretiens constituent l'esprit des contrats qui seront précisés à bref délai. Au cas où les difficultés surgiraient entre nous pour la mise au point définitive des contrats, nous vous proposons, au cas où nous ne pourrions nous mettre d'accord, de nous référer à l'arbitrage de la C.C.I. à Paris."

The author of the letter finally asks the addressee to return the signed copy of the contract to indicate his agreement.

Commentary: Here again, only the contract documents are left to be drawn up, the contracts already having been concluded. The existence of final obligations is explicitly confirmed and the performance of the contracts is to commence without further delay. The letter in question amounts to an invitation to lay down, in writing, the agreement on the basic elements of these contracts in order to constitute provisional contract documents. One should note the interesting arbitration clause relating to subsequent disagreement on the finalization of the contract documents.

Example 6—Condition Precedent

Presentation: Companies A and B establish a document recording the various elements of an agreement reached during their negotiations. They specify that

> "les engagements découlant de la présente lettre d'intention sont sujets à l'approbation des autorités compétentes (of the two countries in question)."

Commentary: In principle, this is a contract with a condition precedent. In French law, such a contract is considered to exist *in seed* as long as the condition is not satisfied. Once the condition is satisfied, the contract enters into effect retroactively to the date agreement was reached. If the condition is not satisfied, nothing is considered ever to have had effect. The event constituting such a condition must be a future and uncertain event; the condition precedent must not be purely *potestative*, i.e., depend on the sole wish of a party that undertakes it (Article 1174 C. iv.). The document, which sets out agreement between negotiating parties on certain points while reserving further issues to be agreed upon later during negotiations, cannot, for this reason, be regarded as a contract subject to a condition precedent.

Example 6 illustrates a very common situation. Numerous international contracts require the total or partial approval of public authorities of the countries in question. The need to obtain these authorizations introduces a condition precedent to the full effect of the agreement. These are certainly future and uncertain events, not solely depending on the will of the party undertaking them.

We must, however, qualify this conclusion. Firstly, where the authorization is to be obtained from the authorities of the country of which one party in question is itself a public body, it is not always evident that the will of the party and of the governmental body are absolutely distinct. Further, generally speaking, the chances of obtaining the necessary authorizations depend, in part, on the way in which applications for permits are submitted, and the signatories of a contract containing such a condition precedent assume, in this respect, an obligation to use their best efforts to obtain the required authorizations (compliance with notice periods, with formalities, etc.). Reference was made to the practice of unscrupulous contracting parties causing themselves a denial of their application in order to re-negotiate the contract or the breakdown of contractual relations. In order to curb such a practice, some contracts that are subject to prior authorizations expressly oblige the parties to do all that is necessary to

obtain the required approvals.[14] A provision for liquidated damages might even be considered in certain cases. The refusal of authorization would, in any event, prevent the fulfillment of the transaction, but the contracting party in breach may be held liable. Finally, the relevant regulations can make the necessary authorization a feature essential to the formation of the contract, so as to make it a *"contrat solennel"* (i.e., a contract for which some formality is a pre-requisite). In such a case, the contract is only formed at the moment authorization in obtained, and until then it does not even exist *in seed.* The obligation to work to obtain the necessary authorization still exists.

Governmental authorizations are clearly not the only possible examples of conditions precedent capable of inhibiting the full effect of international contracts. This can also be made to depend, for example, on obtaining adequate financing, or on the conclusion of a complementary contract with a third party (cf. below Example 11).

Example 7—Entry Into Force Clause

Presentation:

"The contract will only come into force when the following conditions have been fulfilled: (a) Approval of the contract by the competent (governmental) authorities . . . not later than 60 days after the date of signature of this contract; (b) Receipt by the supplier of the down payments mentioned throughout Article XIII not later than 60 days after the date of signature of this contract; (c) Receipt by the investor of the performance bond as mentioned in Article III, within 60 days after the date of signature of this contract. . . . Each postponement of one of the dates mentioned in paragraphs (a) (b) and (c) will result in a postponement, with at least the same period, of the dates of putting into successful trail operation of the exchange ordered."

Commentary: How should one analyze this Entry into Force Clause?

Paragraph (a) takes the form of condition precedent as in Example 6. But a period is specified for the satisfaction of this condition. What then if the condition is not satisfied within that? In other circumstances one could liken this to a condition that has failed, thereby destroying the contract from the beginning. Certain international contracts do adopt such a mechanism, but here the intended effect is less radical: the various periods set for the performance of the contract will be put back by a period corre-

[14] On *Best Efforts* clauses, cf. *infra*, Chapter 4.

sponding to the one required for authorization. But beyond that, once authorization is obtained or refused, the normal rules regarding conditions precedent will apply.

As for events stated in sub-clauses (b) and (c), they are not conditions precedent. In fact, these events consist of the performance of certain contractual obligations; naturally, the very purpose of a contract cannot be made into a condition. Rather these are clauses setting out the inter-dependence of reciprocal obligations, certain effects of the contract being suspended while the obligations stipulated in (b) and (c) are not yet performed. Although the last sentence provides a similar result in the case of mere delay in the satisfaction of the condition, as compared to failure of payment or non-receipt of the guarantee, the difference between the first sub-clause and the latter two becomes obvious when the events in question, instead of being delayed, are not achieved at all: the failure of the condition puts an end to the contract without giving rise to claims between the parties (with the exception of Example 6 where one of the parties actually has caused the failure of the condition), while the non-fulfillment of the obligations set out in (b) and (c) can give rise to contractual claims.[15]

Entry into Force clauses can take many forms. Some adopt the method of a condition subsequent: the contract comes into force on the day of its signature on condition that certain events (e.g., authorization, provision of a guarantee, etc.) be achieved within a stated period after signature. Any analysis must always carefully consider the legal technique adopted.

B. Second Group: Stages in the Negotiation

What is the legal effect of the most common types of letters of intent, which relate to the successive stages of long negotiations, beginning with the initial declaration of purpose to the final detailed listing of results achieved in almost complete negotiations?

Example 8—Initial Intent

Presentation: Firm A writes to Firm B:

> "Après examen des documents que vous nous avez communiqués et suite aux différents entretiens que vous avez eus avec notre ingénieur des télécommunications . . . , nous vous informons de

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[15] On the subject of conditions precedent regarding governmental approval and entry into force clauses, consider further examples in and the commentary of Philippe Kahn, in *Le Contrat économique international* (proceedings of the VIIth Journées d'études juridiques Jean Dabin of the University of Louvain), Bruxelles & Paris, 1975, pp. 189–193.

notre intention de vous passer éventuellement commande d'un commutateur téléphonique de type . . . Pour la bonne règle, nous tenons à stipuler que la présente ne constitue en aucune façon une commande."

Commentary: At first sight, this is a straightforward declaration of intent, excluding all legal obligations. The second phrase indeed appears to confirm this expressly. Why then write such a letter? Facts reveal that it was sent at the request of the negotiator of Firm B, anxious to demonstrate to his superiors that he succeeded in raising interest on the part of his counterparts in Firm A.

Several members of the Group, looking to French law, raised concerns that the issuance of such a letter could have legal effects if A does not ultimately place the order with B. Despite the ambiguity of the terms used, some discerned in the letter a certain affirmation of the negotiations' genuineness, which might lead to blaming A with tortious behavior in the event of subsequent unjustified breach of negotiations. On the other hand, does this letter not at least constitute implicit approval of the technical qualities of the product? Members voiced the opinion that the drafting of such a letter should at least be more circumspect, merely confirming the interest in the product, without mentioning the intention to place an order in due course (cf. below Example 15). In the opinion of the English members of the Group, if subject to their law, such a letter would have no legal effect.

Example 9—Protocol Relating to the Conditions for Licences and Contracts for Cooperation

Presentation: Materials X and Y are parts of an assembly Z. Company A has specialized in the manufacture of material X and Company B in that of material Y. Negotiations took place to reach the conclusion of reciprocal licence agreements and cooperation agreements relating to the manufacture, assembly and supply of the assembly Z. Some time after the start of these discussions, the parties established their position in a "Protocol as to materials X and Y between the companies A and B."

In it are specified "the conditions for participation of B in access to the information concerning the concept and manufacture of material X (developed by A)." These conditions require B to sign four agreements: two licence agreements and two cooperation agreements. The protocol then specifies the extent to which A and B shall participate with regard to material Y. Article 5 sets out the principles by which materials X and Y shall be governed, i.e., (a) the quantities assigned to each of the firms shall in generally be the same for the two types of material; (b) the royalties under

the licence agreement shall be the same and their conditions similar; (c) each contract shall begin and end at the same time.[16]

Commentary: This protocol was signed by parties fully committed to reaching a successful conclusion to their negotiations. The contracts envisaged were indeed subsequently concluded. The object was to establish an agreed-upon basis for the inter-dependence of future agreements and for the precept that a fair balance between the parties' respective interests should be secured. The protocol also establishes the percentage of the respective shares concerning material Y.

What is the legal effect of such a protocol? Clearly, it does not establish the conclusion of the licence contracts or the cooperation contracts, of which only the principle and the general spirit are stated. A substantial start has been made into the negotiation of these contracts, which decidedly distinguishes Example 9 from the preceding one; yet nearly all the clauses remain to be stipulated.

According to the classical analysis of the formation of contracts, which, generally speaking, bestows no specific legal effects upon the different phases of the negotiation prior to the tender, a breakdown of negotiations can only give rise to a damage claim if there are special circumstances amounting to wrongful behavior.[17] Such would be the case, for example, if one could prove that the party, who broke off negotiations, never had a genuine intention to actually reach an agreement and then had, nevertheless, by such a deceptive maneuver, induced the other party to invest substantial and expensive efforts into the negotiations. In this light, one may consider that the fact of having signed the above protocol could contribute to the proof of a tort committed by the party breaking off negotiations without justification.

But in view of such a document, which sets out so clearly that the parties agree on certain important elements at this stage of their negotiations, may one not take this a step further and consider that there already exists a contractual undertaking? The subject matter of such an interim contract could obviously not be identical to that of the final contracts for which most of the clauses are yet to be created. Such preliminary contract would,

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[16] Other terms of this protocol not quoted here in order to reduce the length of the example, set out the obligations of the parties with respect to obtaining the necessary authorizations (see above Example 6) and the confidentiality of the information exchanged (see below Example 21).

[17] At least that is the solution according to French and Belgian law; for a wider view in comparative law, see the synthesis below, pp. 35–37.

in fact, oblige the negotiators, during the continuation of their discussions, to no longer question the elements so far agreed upon. One might add that the parties accept an additional implicit obligation to continue their negotiation in good faith to achieve agreement on as yet unresolved items. But how should one establish negligence or fault in this respect? Besides, what would be the criteria for the calculation of damages? In our discussion of cases and our further analysis hereafter, we will seek progressively to establish elements of answers to these questions.

Example 10—Protocol Relating to the Creation of an Automobile Industry

Presentation: An automobile manufacturer establishes a "framework agreement" with a foreign state. The preamble to this document records the wishes of the state to achieve the creation and development of an automobile industry within its territory and the wish of the manufacturer to produce its vehicles in the country in question.

> "Les deux parties se sont mises d'accord sur la nécessité d'atteindre les plus hauts volumes de production et de valeur ajoutée locale, le constructeur développant les installations nécessaires et l'Etat accordant, dans le cadre des conventions internationales de commerce, les protections nécessaires pour donner aux véhicules produits localement un avantage de prix décisif sur les véhicules importés. Les deux parties, à la suite de négociations, sont convenues d'établir un accord définitif, dont le cadre est résumé par les dispositions suivantes qui engagent les deux parties."

The remainder of the protocol covers some ten pages, which, in essence, state: the purpose of the final agreement is the creation and operating of an industrial complex for the production of cars, with parts imported from the manufacturer's country and later with parts manufactured locally under licence, or purchased from local suppliers. A local limited company shall be formed for the purposes of acquiring the parts needed to assemble the cars and to distribute them. The size of its capital is given as well as the respective percentages of the local (the State) and foreign shares (the manufacturer). The outline of the final contract is already planned so far as production volume and percentages of locally added value are concerned. The methods by which the development of local manufacture of parts will be encouraged are set out. In return for exclusive licence granted by the manufacturer and the contribution of its technical assistance for the manufacture of parts, the new company will pay a royalty that is to be fixed in the final agreement; the protocol already set out some of the elements for this calculation. The financing of the new company is the subject of several clauses, which contain, in particular, an estimate of the amount necessary for the construction of the factory and of the portions of this amount

that shall be financed by the new company, by foreign and by local loan. Finally, it is provided that a final agreement shall be signed within four months thereby establishing the obligations of the manufacturer, which in the protocol are merely listed in a series of headings (e.g., licences and know-how, selection of local parts, training of personnel, prices, etc.). The State undertakes on its part to grant the new company various rights, which are also listed (exclusive joint production, compulsory purchase of land, exemption form customs duties, etc.). The protocol ends with a schedule for subsequent steps: studies, signature of this final agreement, establishment of the new company, signature of the licensing agreements.

Commentary: Those who signed the protocol saw in it the consecration of their agreement on the "economic envelope" of the operation, the "legal content" remaining to be established. Since exterior funds had to be raised, the protocol's publication in the Official Gazette of the Manufacturer's country would facilitate securing the financial package for the transaction. The final agreement, to which the protocol so frequently alludes, was subsequently signed; circumstances, however, prevented its performance.

Despite this defined opposition between the economic character of the protocol and the legal character of the agreements remaining to be drafted, it seems that this protocol itself gives rise to legal obligations to each party. The preamble does expressly state that "the following provisions . . . bind both parties." At the level of formalities, the protocol was drawn up in duplicate and signed by each of the parties.

As in the preceding example, the agreement reached is not to be confused with the final agreement, of which many provisions remain to be determined. But this document sets out the state of the negotiations, summarizes in detail the results achieved and prescribes a timetable for the completion of the necessary contractual documents. We consider that such a document at least obliges the parties not to question again anything that was already agreed upon, to respect the timetable for future negotiations and to act in good faith to assure a successful conclusion. This proposed analysis is the same as that for the preceding example: it seems to follow even more strongly, in view of the apparently more advanced stage of the negotiations: Example 10 is already extremely detailed as concerns the various points of the contents of the agreements to be prepared.

Example 11—Protocol Relating to a Program for Integrated Aeronautical Production

Presentation: Several companies from various countries decide to collaborate in the creation of a program for integrated production in the aeronautical sector. One of these companies negotiates the terms for the

overall transaction with a State, which itself acted on behalf of a group of States desirous to place orders. Among the various companies concerned, several protocols are exchanged (the expression memorandum of understanding is also commonly used), which establish the basis for their cooperation in due course, provided the principal negotiations succeed. The protocols establish the major features of the respective obligations. But many elements are still uncertain and will be determined by the content of the future agreement between the negotiating State and the "client" company.

Commentary: This example illustrates another situation in which documents set out the agreement between the parties on the major elements of their future contracts, while the precise content remains to be established in many respects. But in this case, the completion of the contractual set-up does not depend primarily on the continuation of negotiations between the parties; it is mainly dependent on the result of further negotiations by one of the parties with a third party. We may consider that the obligations imposed by these protocols are not to put into question again the bases agreed except to the extent that the result of the final content of the agreement between the State and the client company may demand it, and the participants are to work towards the successful conclusion of these particular negotiations informed by the results of the principal negotiation.

This hypothesis is not to be confused with that of an agreement that might result subject to a condition precedent of the successful conclusion of another agreement with a third party (cf. above Example 6, where the condition precedent was a governmental authorization). A contract subject to a condition precedent is complete in all respects, subject only to the condition. In the present case, numerous aspects of the future contractual relationships remain undetermined at the stage of the protocol, since they cannot be specified until after the conclusion of the principal contract.

In this case the protocols play a part at a stage when a network of contracts is being set up. Some of the contracts must be negotiated by reference to others. They cannot be completed before the main contract is finalized.

Example 12—Orders in Successive Lots

Presentation: In the context of the creation of an enormous program of aeronautical production, one company sends a sub-contractor a so-called order expressed as follows:

> "La présente commande a pour objet l'exécution d'une première tranche de 30 ensembles . . . dont la commande a été passée par notre lettre du . . . , et d'une seconde tranche de 55 ensembles . . . destinés aux avions . . . commandés à notre société par (tel pays).

Seule la première tranche est commandée ferme. La réalisation de la seconde tranche est subordonnée à une commande de notre société qui fera l'objet, soit d'avenant à la présente commande, soit d'une commande séparée."

Commentary: This example illustrates the common existence of pre-contractual documents drafted so badly as to be incomprehensible. The letter above manifestly contains a contradiction as to the second batch, which at first appears to be included in "this order," but it is then described being subject to a later order. One cannot stress sufficiently the need of avoiding such confusion.

Leaving aside the defective drafting of this letter, we find, according to the explanations provided by a member of the Working Group, a firm order for the first batch of work, and an announcement of the probable order for the second batch. The terms of the second order are not to be necessarily the same as those of the first; changes may be negotiated in the event of a change in circumstances, for example in the level of salaries.

This illustrates another situation in which the phenomenon of "letters of intent" is apparent. In the context of long-term relations, the issue of a firm order is often accompanied by a declaration of intent relating to subsequent portions whose performance will depend on transactions to be concluded by the author of the initial order.[18] Sometimes the whole is the subject of a global order, but it is agreed that the conditions of successive deliveries shall be negotiated at periodic intervals. The lack of essential terms about these future orders prevents these orders from being concluded. The Group, however, considers that the intentions expressed as to future batches create an obligation to negotiate their terms in good faith.

Example 13—Final Details to Be Completed

Presentation: Firm A sends Firm B the following fax:

"Thank you for your fax of 13th August. We have the intention to award the . . . project to you and thus request you to send autho-

[18] One may compare this situation with the practice of framework agreements, common in particular for the supply of metallurgical products or in the field of commercial distribution, where the parties agree to organize their long-term business relations on a contractual basis (exclusivity or priority, reciprocal exchange of information, elements governing the establishment of prices, quantities or minimum supplies, quality, periods for delivery, etc.), each individual delivery being, however, the object of separate negotiations (in order to determine especially quantity and price), consistent with the rules established in the framework agreement. The future contracts are obviously not formed at the same time as the conclusion of the framework agreement, but the latter imposes precise obligations which bind the parties in the negotiation of those further contracts.

rized representatives immediately to discuss and finalize details and consequently sign the contract. Best regards. . . ."

Commentary: Compared with the previous examples, we reach here an even more advanced stage of the negotiations. The essential part of the contract has been achieved, and only some details remain to be settled; the parties are no longer in any doubt about a possible quick agreement. With the exchanges of such faxes, the parties accept the results previously achieved and undertake to do all necessary to settle by mutual agreement the final details for conclusion of the final contract.

One may even wonder whether, at this stage, where all the essential clauses have already been agreed upon and despite the use of the expression "we have the intention to award the . . . project to you," the final contract has not already been achieved. The example is not very different from Examples 3 and 4, in which only the formal contract document remained to be settled. The only difference seems to lie in the fact that several last details remain incomplete. Certain legal systems consider that a contract should be regarded as concluded as soon as agreement is achieved on the major points; we will return to this in our synthesis.

C. Third Group: Letters Without Binding Effect and Clauses Excluding Liability

In the second group of examples, the majority of documents examined appeared to the Working Group to bind contractually the signatories to continue their negotiations in good faith, without unjustifiably re-opening the results already achieved. It sometimes happens that documents of similar content call for a different analysis, either because the letter expressly excludes any contractual undertakings, or because, by virtue of special circumstances, or the absence of proper authority on the part of one of the authors, the possibility of contractual obligations must be excluded.

Example 14—The Subject to Contract Clause

Presentation: The agent of an intended purchaser of a building writes to the owner to confirm the outline of an agreement reached in a telephone conversation. Various terms are set out; the main one is as follows:

"The freehold of the entire property is to be purchased at a price of £125,000, subject to contract."

Commentary: The phrase "subject to contract" is intended in English law to deprive the text in which it appears of all legal force. Its effectiveness is well recognized. No contractual obligation can be derived from a document that includes this phrase. The expression is sacred (one sometimes finds the fuller expression "subject to contract and survey"), but the same

effect can be achieved by a choice of words expressly setting out the intention not to assume any legal obligation, to put oneself outside the law. In English law, the insertion of such formulae puts beyond doubt the effect of the documents so drafted in the course of negotiations.

Can the same be said of other legal systems? A number of members of the Group consider that on the European continent, just as the courts will look beyond misleading expressions used by the parties, the tendency would be to disregard an express wish to set oneself outside the law, if the situation presented all the characteristics of a legal result. Should one, nevertheless, not distinguish those examples where the apparent absence of any legal engagement results from some clumsy, ambiguous or mistaken expression of the will of the parties (see above Examples 1–4) from those where the draftsman of the document deliberately and expressly places himself outside the law?

Example 15—"Sans Être Contractuel"

Presentation: Negotiations have started for the purchase of a majority interest in several companies. The interested buyer writes to the other party:

> "Nous avons l'honneur de vous confirmer que nous sommes intéressés par la possibilité d'acheter une participation majoritaire qui pourrait aller jusqu'à un maximum de . . . % dans les sociétés suivantes: . . ."

The price states the total price of the operation, but "comme nous ne connaissons pas encore bien les sociétés en question" no purchase is envisaged before the end of the year. Nevertheless, they might proceed immediately with a management contract and an agreement for sale.

> "Nous aurions bien sûr, à discuter les détails de tous ces documents . . . ; mais si notre proposition vous semble être une base pour des négociations, nous vous prions de bien vouloir nous retourner le double de la présente lettre revêtu de votre signature, qui doit être précédée de la mention "Bon pour lettre d'intention seulement, sans être contractuel."

Commentary: This is an attempt to transpose into a text, governed by French law, the clause subject to the contract that was the subject of Example 14. The effectiveness of the expression is supported by the prudent drafting of the rest of the letter, and in light of the many uncertainties that weigh over various other aspects of the proposed transaction. One should compare this well thought out expression with Example 8 ("We hereby inform you of our intention to award you in due course the order . . .").

Example 16—Misleading Acceptance of an Offer, With a Clause Excluding Liability

Presentation: A letter of award is expressed as follows:

"We hereby inform you that your company has been awarded by our organization an order for equipment, as described in your tender. As some inconsistencies exist between your proposal and our requirements, we kindly invite you to review the technical aspects and contract terms with us. In case no agreement is reached on all terms and no contract is signed before . . . we reserve the right to cancel this award, without any right for indemnification from your part."

Commentary: In Examples 1 and 3, despite appearances to the contrary, we assumed that offers had been accepted and, consequently, that final contracts were concluded. Here the reverse is the case. The first phrase of the above letter certainly appears to provide the acceptance of the offer. But this is contradicted by the following phrase. The consensus is not complete, the contract cannot as yet be concluded and thus the discussions are still continuing.

However, does not the preciseness of the first phrase engender certain obligations on the part of the author of the letter? The concluding clause shows another possible means to change the legal effect of a pre-contractual document. Apart from clauses rejecting all legal effects (see Examples 14 and 15), other provisions can merely envisage to limit or exclude liability in the event of the breaking off of negotiations. One should note here that the clause can only be applied when a certain negotiation period has lapsed. According to general principles, such a clause could not be effective in the event of a fraudulent break down of negotiations.

Example 17—No Obligation and Exclusion of Liability

Presentation: A writes to B:

"Comme suite à nos précédents entretiens, nous vous confirmons que nous envisageons d'examiner vos propositions concernant la vente des participations majoritaires que vous détenez dans les sociétés suivantes."

Also, the terms of the transaction are repeated: price, completion in three stages.

"Il est bien entendu qu'en ce qui concerne notre société, aucune décision n'a été prise relativement à cette acquisition, une telle

> décision étant subordonnée à diverses considérations d'opportunité . . . Il est en outre entendu que dans l'hypothèse où nous ne donnerions pas suite à ces propositions . . . , nous serions libres de tous engagements à votre égard, étant précisé que vous renoncez d'ores et déjà à toute indemnité."

B acknowledges and confirms this.

Commentary: This letter brings together the two methods that appeared above limiting the legal effect of a pre-contractual document: a statement of absence of all and any obligation is reinforced by a clause excluding liability. This clause is not superfluous since the exclusion of any contractual commitment does not prevent an action for tort damages in the event of an improper breach. One should remember, as well, that the clause excluding liability does not permit evading the consequences of fraudulent conduct. The text of the letter is carefully prepared with a view to providing evidence of the lack of obligation: the reference to *"considérations d'opportunité"* is significant in this respect.

Example 18—Fictitious Negotiations

Presentation: Two companies enter into negotiations concerning the completion of an extremely complex transaction. At an advanced stage of discussions, the parties agree to abandon the project, but they jointly decide to continue the negotiations nevertheless, hoping to find solutions to the difficult problems that they had encountered. The experience thus acquired could be useful to each of them if, for example, the project were to proceed at a later stage.

Commentary: In this extraordinary (but true) situation, the documents, which evidence the later stages and finally the result of these platonic negotiations, clearly have no legal effect. This is an exercise in method, a business game taking place and no longer the negotiation of a real contract. All intent to form a contract has vanished. Still, one should be extremely careful to remove any ambiguity between the parties about the meaning of the continuation of the discussions after they were broken off (in the case in question, explicit letters were exchanged).

Some members of the Group wondered, however, whether once the further stages of the "negotiations" were completed, the parties would be free to use the results in contracts with third parties. Further, if the parties later decided to attempt again to complete the project together, would they be obliged to take the results of their fictitious negotiations as a start of their new discussions?

Example 19—Absence of Authority

Presentation: A director of Company A negotiates at length with Group Z regarding terms for the transfer of a substantial interest that Company A holds in Company B. By a letter to Z, the director sets out, in detail, the results achieved in the negotiations. Before signing the letter he adds in handwriting:

"Subject to the approval of the Board of Directors of Company A."

When Group Z replies to the letter and confirms its agreement, Company A refuses to perform. Group Z sues Company A for breach of contract.

Commentary: A Belgian court refused any legal effect to the agreement reached between the director and Group Z, holding that this was subject to a condition that was purely discretionary (the approval of the Board of Directors of Company A).[19] However, one may wonder whether this is not rather a question of lack of authority. A director alone does not have the authority to bind the company where the transfer of the interests in question is concerned; the obligations, which it might claim to undertake, have no legal effect (cf. Example 6).

This case draws the attention to a preliminary question that must be resolved before forming an opinion about a pre-contractual document: is it issued by signatories bearing the necessary powers to bind the companies or organizations which they represent? Attention is drawn to this essential requirement, subject, of course , to rules, which in all legal systems and under certain circumstances, protect third parties contracting in good faith with an unauthorized agent. Our discussion of all the other examples assumes that the question of authority does not arise.

D. Fourth Group: Firm Agreement About Certain Particular Aspects of the Negotiations

This final group of examples relates to situations outlined in letters of intent in which the parties incontestably assume precise contractual obligations with regard to certain limited aspects of the negotiations.

Example 20—Exclusivity

Presentation: Initial contacts take place between two groups with a view to the transfer of various shareholdings and trade marks. One of the groups writes to the other:

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[19] The decision was appealed; the parties settled.

> "Nous . . . avons pris note que votre groupe envisage la possibilité d'acheter . . . des actions des sociétés . . . ainsi que des marques. . . . Afin de vous permettre d'étudier cette possibilité, nous prenons conjointement et solidairement l'engagement irrévocable vis-à-vis de votre groupe de ne procéder à aucune négociation quelle qu'elle soit ni de vendre à un acheteur éventuel tout ou partie des titres des sociétés ou marques énumérées ci-dessus, et ce jusqu'au. . . ."

Commentary: At an apparently early stage in the negotiations, one of the parties is undertaking a precise obligation toward the other, i.e., not to enter into parallel negotiations with any third party for a certain period of time. Whatever one may think of the legal effect of the first sentence of the letter, it appears beyond dispute that the second sentence imposes on its author a contractual obligation of exclusivity (contractual upon at least tacit acceptance by the promissee). The unilateral or reciprocal undertaking not to negotiate with any third party during the continuance of negotiations provides our first example of the various types of pre-contracts with a well defined purpose likely to arise during negotiations.

In the absence of an express agreement as to exclusivity, would not an obligation to abstain from negotiations with third parties exist implicitly? One can certainly not claim this as a general rule. Parallel negotiations are common currency, even at a very advanced stage of negotiations. They are even indispensable in the normal to-and-fro of competition, and their legitimacy cannot, in general, be contested. But the situation can be different if the parties introduce into their negotiations contractual elements that we think can be found in some of the previous examples (Examples 9 and 13). Does not the obligation to negotiate in good faith imply an undertaking as to exclusivity? The answer must depend on the particular facts; it seems to depend on how far advanced the negotiations are and on whether the other party is or is not aware of the continuation of parallel negotiations.

An express clause, as in the present case, has the virtue of avoiding all doubt.

Example 21—Promise of Confidentiality

Presentation: A letter of understanding relating to a feasibility study prior to contract negotiations and possible contract conclusion, includes an Article 15 according to which

> "Any proprietary information, including but not limited to, technical and financial information disclosed by either party to the other hereunder and designated as confidential shall be kept secret and confidential and not used by the receiving party other

than in the course of the feasibility studies, or other evaluation contemplated hereunder nor disclosed by such party other than to its employees requiring same for performance of their duties hereunder, unless and to the extent such information was known to the receiving party prior to disclosure hereunder, is subsequently disclosed to the receiving party by a third party or becomes public knowledge. The obligations of this Article 15 shall survive termination of the letter of understanding and continue in effect for a period of 7 years thereafter."

Commentary: This second example of a limited contractual agreement arising out of preliminary negotiations concerns an obligation to consider as secret all information received. One should note the details of the clause, in particular the time limit on the obligation of secrecy in the event of final breakdown in negotiations that may have been caused by competition law concerns.

As with exclusivity clauses, one may wonder whether, in the absence of an express clause relating to the secrecy of information exchanged, an obligation to respect the confidential character of that information would not exist by implication where there is an obligation to continue negotiations in good faith.

Examples 22 and 23—Obligations as to Timelines for Negotiations

Presentation: A letter of intent states that

"Considering the urgency of this project . . . the contract will be signed as soon as possible after the initial discussions, and every effort will be made to make this possible within 30 days of the beginning of the initial discussions."

Another letter provides that

"Within 120 days after completion of the . . . feasibility study, each party shall inform the other as to whether it wishes to implement the project. In the event either party fails to so inform the other, or decides not to implement the project, this letter of understanding shall be thereupon deemed terminated and neither party shall have any obligation thereafter to the other (subject to surviving secrecy obligations)."

Commentary: Another contractual aspect of the progression of negotiations is often the fixing of periods for the accomplishment of the various stages of the discussions, and principally for the conclusion of the definitive contract. The two examples given illustrate two different ways of for-

mulating these obligations. In the first example, the clause imposes on the parties a simple obligation to try and respect the time constraints. In the second case, exceeding the prescribed period acts as a condition subsequent, terminating the obligations arising from the letter of intent.

Example 24—Organization and Payment of the Costs of Preliminary Studies

Presentation: A chemical company and a public authority in a developing country record, in a letter of understanding, their agreement to proceed with the establishment of a petrochemical complex in the country in question. The letter provides, however, for the completion of preparatory studies:

> "Within sixty days following the date hereof, the parties shall appoint a team comprised of a mutually agreed number of representatives of each party to undertake feasibility studies for the establishment in . . . of a facility to produce the aforesaid products. . . . The costs of the study agreed to by the parties in advance shall be shared equally by the parties with a net billing settlement between the parties at the conclusion of the study. If the project is implemented, the agreed costs will be borne by the . . . . If the project is not implemented, the agreed costs after the net billing settlements will be borne equally by the parties."

Commentary: Frequently, negotiators of substantial operations recognize the need to proceed with preliminary studies to determine the feasibility of the project. The organization of these studies can be the subject of a contractual agreement, the two parties agreeing who shall undertake this work (in the example given it is a group of representatives of both sides, but it could as well be one party only or a third party), what schedule to follow, who will bear the costs of the studies, whether the results lead to the realization of the project or not. The clause dealing with the cost should preferably specify which expenses should be taken into account, either by providing for reimbursement only of those expenses jointly agreed upon, or that one should apply a test as to the reasonableness of the expenses, or one might set out in advance a list of the type of expenses that would be considered reasonable.

Clauses relating to feasibility studies form yet another precise contractual obligation undertaken in the course of negotiations of a future main contract.

What is the position in the absence of such a clause if one of the parties proceeds with expensive studies and the negotiations break down? The reimbursement of such expenses would constitute an important element

of the damages whose reimbursement would be claimed either in tort, in those exceptional cases where the breaking off of negotiations can be considered as a tort, or in contract, if the parties have expressed in a letter of intent the seriousness of their discussions and if such a document offers grounds for a contractual obligation to continue negotiations in good faith. Obviously, an express clause about the reimbursement of expenses will clarify the situation.

Example 25—Acceptance to Bear the Cost of Negotiations

Presentation: A letter of intent sets out the terms on which Company X might be prepared to acquire the capital of Company Z. Among these terms are certain conditions precedent relating in particular to the results of an accountancy investigation and to obtaining the necessary foreign exchange permits. The letter contains the following passage:

> "If, having accepted the terms of this letter in principle, and if a formal agreement is not entered into because a condition fails to be satisfied then each party should bear its own costs. If, however, shareholders of Z should determine not to proceed for any reason then we feel it is appropriate that shareholders should bear the costs of X incurred in connection with the negotiations and investigations. Equally, if X withdraws from negotiations otherwise than for a failure of a condition to be satisfied then it would expect to bear the costs incurred by shareholders."

Commentary: If Z gives its agreement to the contents of this letter, the passage just quoted will provide another type of contractual undertaking defined before the conclusion of the principal contract: an agreement that the party responsible for the breakdown of negotiations should bear the expenses of those negotiations. This example resembles Example 24, except that here it is not a question of the costs of a preliminary study, but the cost of the overall negotiations. The presence of such clause in some letters of intent tends to confirm the interpretation that documents of this kind can create obligations relating to continuance of negotiations, and that breach of such obligations can give rise to claims for damages. The quantifying of damages, in the absence of any clause, gives rise to similar difficulties, which will be considered later in this chapter. The letter here expressly opts for a minimal provision: the reimbursement of the costs borne as a result of negotiations. One should note that this reimbursement occurs in the event of a break "for any reason" (except if the break is caused by the failure of a condition), without it being necessary to establish the lack of justification for the break.

One should note the differences between this clause and those discussed in Examples 16 and 17 in which, by contrast, it was provided that the breaking off of negotiations should not give rise to any claim.[20]

Example 26—Authorization to Start Work

Presentation: Company A writes to Company B:

"Nous avons l'intention de vous commander les travaux complémentaires prévus pour déterminer la faisabilité d'un moteur à gaz léger, suite à votre télex du . . . concernant votre proposition technique et financière répondant à notre consultation, et qui a reçu l'accord des services techniques. La commande définitive . . . vous sera adressée dès que l'avenant I au contrat No. 600330 en cours de finition vous sera notifié. Vous êtes autorisés par la présente lettre à engager un montant plafond de 1 175 325 FB . . . couvrant les travaux ci-dessous (suit une énumération chiffrée des travaux à entreprendre). Nous vous demandons de bien vouloir confirmer votre accord en nous renvoyant le double de la présente lettre signé par vos soins."

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[20] This clause can also be compared to clauses of American origin providing for lump-sum damages in mergers and acquisitions operations. In a letter of intent, the company to be acquired undertakes to pay a certain indemnity to the acquiring company in case of breach ("break-up fees" or "termination fees"). In the United States, such indemnities vary between 1 and 3 percent of the price of the acquisition. The validity of such clauses can be questioned insofar as they may serve as a means to finance the acquisition by the acquired company itself and—in relation to takeovers of listed companies—to the extent they are not compatible with applicable securities regulations (*Financial Times*, July 17–18, 1999). One may also wonder whether the Board of Directors is authorized to sign such an agreement and whether such clauses do not go beyond the company's objects (cf. H.J. de Kluiver, De Ondernemingsrechtelijke Contractpraktijk: Onderhandelen in de Schaduw van de wet, *Contracteren*, 2001, 8, quoting *QVC v. Paramount*, February 4, 1994, 637 A.2d 34 (Delaware Supreme Court)). In the law of contracts, such clauses do not raise any problem when they only envisage to reimburse the costs of the negotiation, and—in accordance with the applicable law—to determine in advance the amount of damages due in case of breach of confidentiality and exclusivity undertakings. Difficulties appear when the clauses tend to have a dissuading effect, limiting the freedom of the company to decide whether or not to engage itself. On the other hand, the scope of such clauses is not limited to the hypothesis of a reproachable breach of negotiations as they apply to all types of withdrawal. One may then wonder if they are not to be considered as exit clauses bringing negotiations to an end (cf. R. Christou, *Drafting Commercial Agreements*, 2nd ed., London, 1998, pp. 362–363. Compare, for instance, the prospectus stating the elements of the merger agreement between B.P. and Amoco and providing for damages to be paid in case the merger does not go through). In these respects, a precise qualification is only possible based on the text of the letter of intent and all concrete elements.

Commentary: Negotiations are very advanced, but a number of points remain to be settled. Nevertheless, being nearly certain that a final agreement will be reached and considering the urgency of the project, the parties decide to start performance of the contract, even though it is not yet concluded. This situation, disconcerting under the classic theory of contract, is far from exceptional. The practice of international contracts reveals that, quite frequently, the performance of vast enterprises proceeds to quite an advanced stage even before the contractual documents that will provide its legal structure are completed.[21] It is here that the letter of intent plays one of its most important roles. Asserting the determination of the negotiators to conclude their work successfully, it reassures those of the parties who are to proceed without further delay with the performance of the project. Authority to proceed is often expressly given and sometimes, as in this example, set out with more or less precision. It constitutes another one of these specific contracts entered into prior to the conclusion of the definitive contract. The first phase of the work is separated from the whole to become the subject of an agreement. The authority to proceed is no doubt the most remarkable phenomenon in the area of letters of intent, by the way in which it puts in doubt the apparently natural distinction between the phases of formation and of performance of contracts.

III. LEGAL CONSIDERATIONS

Each of the examples provided a different situation covered by pre-contractual documents. Was each a "letter of intent"? To give a precise answer to this question presupposes that there exists a well-defined concept of letters of intent. However, the experience gathered by the Working Group shows that this is not so. The expression is used by practitioners in extremely diverse circumstances and often interchangeably with other similar expressions (agreement in principle, protocol of agreement, memorandum of understanding, letter of understanding, etc.). The terms alone cannot determine the real status and effect of the document.

Faced with this terminological anarchy, the method followed by the Group assembled, at the start, the widest possible collection of pre-contractual documents. Discussion of these examples allowed them to be divided into two categories. Firstly, one series of documents, despite their possibly ambiguous appearance, seemed to fall into well-known legal categories: offer or acceptance, completed contract, contracts subject to a condition precedent, etc. The remaining documents were unclassifiable and provided evidence of the existence, during negotiations, of various forms of agreement not known to traditional categorization.

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[21] *See* Ph. Kahn, *op. cit.*, pp. 186–187.

The commentary, which accompanied the exposition of the various examples, has already stated the principal conclusions of our reflections. We will now seek to present a synthesis and to place the examples in an overall framework, a difficult task given the serious differences that exist among the various legal systems. A particular situation does not necessarily have the same legal effects under all legal systems.

The first section will recall the various situations that can be brought within widely recognized legal categories (Section III.A), and the second section will collect the findings of the group concerning letters of intent, strictly so called (Section III.B).

A. Traditional Legal Categories

An analysis of the extremely varied documents exchanged during a long negotiation reveals, once one has stripped off the qualifications resulting from the frequently imperfect expressions, the presence of various known legal forms.

1. Offer and Acceptance

Offer and acceptance of the offer are unilateral declarations of will, which come together in the conclusion of a definitive contract. An offer constitutes a complete contractual proposition, to which it is sufficient to add the adhesion of its addressee (which is the purpose of acceptance) for the contract to be concluded. Under certain jurisdictions, an offer is considered to be irrevocable, during the period provided for in the offer, or absent such a period, during a reasonable period. Under other legal systems, an offer may remain revocable as long as it has not been accepted. But in all cases, unqualified acceptance completes the contract and definitively binds the parties (see Example 1; and compare with Example 16). This result is generally accepted, but differences exist as to the precise moment when, the parties not being together, the acceptance is deemed to meet the offer.[22]

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[22] On these various aspects of the formation of the contract in comparative law, see, e.g., R.B. Schlesinger, *Formation of Contracts: A Study of the Common Core of Legal Systems*, New York and London, 1968, 2 vol.; International Chamber of Commerce, *Formation of Contracts and Precontractual Liability*, Paris, 1990; K. Zweigert & H. Kötz, *An Introduction to Comparative Law*, 3rd ed., 1998, pp. 356–364; C. Delforge, La formation des contrats sous un angle dynamique, Réflexions comparatives, in M. Fontaine (ed.), *Le processus de formation du contrat—Contributions comparatives et interdisciplinaires à l'harmonisation du droit européen*, Brussels and Paris, 2002, pp. 139–478.

2. Promise to Contract

A *promise to contract* constitutes, by itself, a contractual obligation of a distinct kind. Its purpose is to commit a party to the conclusion of a definitive contract, whose elements have already been agreed upon. A bilateral promise binds both parties to contract. In legal systems where the meeting of minds suffices to create a contract and where the validity of the contract does not depend upon the fulfillment of some formal conditions, a bilateral promise to contract is often indistinguishable from the contract itself. As to a *unilateral* promise, it only obliges one party to contract, if the other exercises its option.[23]

3. Definitive Contracts

Several of the documents examined were considered to be definitive contracts despite some ambiguity in the terms used. Sometimes we find a straightforward acceptance of an offer (Example 1), despite the request for acceptance by the addressee. Sometimes one of the parties seeks to disguise the reality of his obligation behind obscure terminology (Example 2). Sometimes the parties still have to prepare a formal document of their agreement, and are mistaken about the moment at which they are bound, losing sight of the principle that, as a rule, contracts are not subject to formal requirements (Examples 3 and 4).[24]

One should distinguish cases where the parties clearly declare their intention not to assume any legal obligation (Examples 14 and 15, 16 and 17). It is also possible that the parties consciously intend to derogate from the above principle and make the drafting of the contract a fundamental condition of the creation of their obligations. In cases of doubt on this point, the problem of interpretation encounters a wide variety of solutions anchored in comparative law.[25] It may also occur that the law itself submits

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[23] In French and Belgian law, see J. Ghestin, *Traité de droit civil, Les obligations, Le contrat: formation*, 3rd ed., 1993, No. 332–342; H. de Page, *Traité élémentaire de droit civil belge*, II, 3rd ed., 1964, II No. 505–513. In English law, the absence of consideration deprives a unilateral promise of binding force; in practice a remedy is found in obtaining payment of the nominal sum (e.g., £1) by the grantee of the option; see P. Ellington, The English concept of contracts, *D.P.C.I.*, 1976, p. 484.

[24] On this principle in French law, see J. Ghestin, *op. cit.*, No. 363–384; in Belgian law, H. De Page, *op. cit.*, II, No. 464 and 465; in English law, Anson's Law of Contract, 7th ed., 1998, p. 78.

[25] See R.B. Schlesinger, *op. cit.* I, pp. 177–182; Chitty on *Contracts*, 26th ed., 1989, No. 109; F. Kessler & E. Fine, Culpa in contrahendo, Bargaining in Good Faith and Freedom of Contract: a Comparative Study, 77 *Harvard Law Rev.*, 1964, p. 414. The German Code expressly creates the presumption of an intention to make the contemplated drafting of a final document a condition for the formation of the contract, (§ 154 para. 2): see Palandt, *Bürgerliches Gesetzbuch*, Munich, 58th ed., 1999, p. 151.

conclusion of the contract to certain form requirements, in which case the mere meeting of minds does not suffice to bind the parties.

On the other hand, a letter of intent will not be confused with a definitive contract deliberately leaving certain elements to later determination (contract with open terms), nor with framework agreements, which are final contracts themselves, even though they will be implemented by negotiating further contracts. Those techniques, which pose well-known legal problems, do not belong to the subject matter covered in this chapter.[26]

4. *Condition Precedent*

A definitive contract may be concluded subject to a condition precedent. The parties will have reached complete agreement, but their agreement depends on the occurrence of some future and uncertain event, e.g., the obtaining of the necessary authorizations from some public body (Example 6). If the event occurs, the contract becomes fully effective And if not, no contract exists. The subject of a condition precedent must be an event at least partially beyond the control of the parties. When one of the parties is in a position to exercise some influence over the satisfaction of the condition (e.g., by applying for authorization), that party is obliged to do so promptly.[27] It can be useful to specify this in the contract.

The legal concept of the condition precedent is not the same everywhere, in particular so far as concerns the effects of the satisfaction of the condition.[28] On the other hand, certain legal systems make special provision in a situation in which the event, on which the effectiveness of the con-

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[26] Such distinctions between preliminary agreements of the letter of intent type and contracts with open terms and framework contracts are analyzed by E. Allan Farnsworth, Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations, 87 *Col. Law Rev.* (1987), pp. 217–294; J.M. van Dunné, *Verbintenissenrecht*, Vol. 1, *Contractenrecht*, Deventer, Kluwer, 2001, pp. 248–250; F.W. Grosheide, *Naar een juridisch statuut voor internationale intentieverklaringen*, Molengrafica, Lelystad, Vermande, 1989, pp. 119–145; F.W. Grosheide, The gentleman's agreement in legal theory and in modern practice—The Dutch civil law perspective, in *Netherlands Reports to the Fifteenth International Congress of Comparative Law*, Antwerp, Intersentia, 1998, pp. 91–114; B. Wessels, Internationale contractsonderhandelingen, in *Contracteren in de internationale praktijk*, B. Wessels & T.H.M. Van Wechem (eds.), Deventer, Kluwer, pp. 21–46.

[27] This at least is our opinion; it goes further than Article 1178 of the French Civil Code, which is limited to penalizing the promisor who prevented satisfaction of the condition (see F. Terré, Ph. Simler & Y. Lequette, *Les obligations*, 7th ed., 1999, No. 1130). Compare *Infra*, Chapter 4 regarding best efforts obligations.

[28] Retroactivity in France (Code Civil, Art. 1179; see F. Terré, Ph. Simler & Y. Lequette, *op. cit.*, No. 1134 and 1139) and in Belgium (same text; see H. de Page, *op. cit.*, 1 No. 164–168); as a rule no retroactivity in Germany (derived from BGB § 179; see Palandt, *op. cit.*, 157).

tract depends, consists in obtaining an authorization or an approval,[29] even making the obtaining of such approval a condition essential to the formation of the contract.

5. Entry Into Force Clauses

Entry into force clauses, frequently found in documents exchanged between negotiators, can have a variety of legal effects, which only a careful analysis can fully distinguish: a clause delaying the moment when obligations become due, a condition precedent, a condition subsequent, a suspension of the obligations of one party while waiting for the performance of certain tasks by the other party, etc. Generally speaking, it would appear that these clauses do not prevent the creation of a contract, but they cause variations as to the start of performance (Example 7).[30]

6. Problems of Authority

Agreements are sometimes reached by persons not bearing the necessary authority. A legal person can only act through corporate bodies, officers or agents to whom the necessary powers have been granted. Similarly, a person claiming to be the agent of a physical person cannot, generally speaking, bind the principal except within the limits of the powers conferred upon him. The well-known legal problems raised here are extremely complex and solutions vary from country to country, in particular as concerns the degree of protection given to third parties who have dealt with an unauthorized agent.[31] We will limit ourselves to noticing here the effect of this question so far as concerns letters of intent. As a rule, a draft agreement established by a negotiator lacking the necessary powers does not contractually bind the principal. It can only create obligations in tort, of the negotiator, and in some cases the vicarious liability of the principal (see Example 19).

B. Specific Letters of Intent

1. Legal Nature

Having distinguished and put aside the various situations just described, the collection of examples brought together by the Group still left a large

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[29] This is the case in German law: see §§ 182–185 of the BGB (see Palandt, *op. cit.*, pp. 178–182).

[30] See, however, N. Terki, La clause d'entrée en vigueur dans le contrat international de longue durée en droit algérien, *D.P.C.I.*, 1983, pp. 221–237, for whom the intervention of a public administration under Algerian law is not a mere condition precedent but an essential requirement of contract formation.

[31] For a comparative study, see Clive M. Schmithoff, Agency in International Trade. A study in comparative law—*Recueil des Cours de L'Academie Internationale de la Haye*, 1970

number of unilateral and bilateral documents relating to the development of a future contract. What legal effect should be attributed to them?

One may note that the legal theory of negotiations has not developed everywhere along the same lines or to a similar degree (a). In any case, the different legal systems widely ignore the phenomenon of letters of intent: discussions in the Working Group have led to a series of reflections on the possible legal impacts of such documents (b) but the common law is more reserved in its approach (c). Such debates are, however, of less importance in jurisdictions where the distinction between contractual and tortious liability is less significant (d). On the other hand, the parties are in a position to determine themselves the legal impact of their pre-contractual agreements, either to deny such agreements any legal value (e) or to provide for specific solutions (f). These elements will be discussed below.

(a) The theory of contract formation has not reached the same degree or stage of development everywhere, nor the same solutions, as far as the legal status of negotiations is concerned.

A priori, as long as the contract is not concluded, the parties are not bound. It even seems normal that full freedom is preserved in a negotiation process where parties explore whether or not a contract with the possible partner is to be concluded. This is the way a competitive market should work.

In civil law countries, however, this freedom encounters limits. Not all types of conduct are permitted. Certain break-downs of negotiations may engage their author's liability, when they occur under circumstances contrary to good faith (e.g., when the breach is accompanied by statements harmful to the partner's reputation, or when it appears that one of the parties entered into negotiation for the sole purpose of learning business secrets, without having ever had the intention to reach an agreement).[32]

The basis for such liability is in torts in countries like France, Belgium or Italy.[33] Under German law, the lack of sufficiently general rules on tort liability led to applying a contractual basis for *culpa in contrahendo*.

I, pp. 107–203. As concerns the representation of commercial companies, attention is drawn to the Directive of 9th March 1968 (*J.O.C.E.*, 1968, No. L. 65, pp. 8–12).

[32] On good faith and negotiations, see B. Jaluzot, *La bonne foi dans les contrats, Etude comparative de droit français, allemand et japonais*, Paris, Dalloz, 2001, pp. 359–372; J.F. Romain, *Théorie critique du principe général de bonne foi en droit privé*, Brussels, Bruylant, 2000, pp. 854–865.

[33] The obligation to negotiate in good faith has been codified in Italy (Article 1337 C. Civ.) but its basis is to be found in tort law (Cass. it., 23 juin 1964, Giust. civ., Mass. 1964, 755); see A. Braggion, Contract proposals and letters of intent under Italian law,

Common law countries are much more reluctant to admit pre-contractual liability. The dominant perception is that in a negotiation each party pursues its own interests. In principle, negotiators keep full discretion including the authority to break off negotiations at any time and at will.[34] Some limits do exist, however, and the law of torts may have a role to play. Developments are under way towards assigning more responsibility to negotiators.

The Unidroit Principles (Article 2.15) as well as the Principles of European contract law (Article 2:301) have codified the principle of liability deriving from behavior contrary to good faith in negotiations.[35]

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in *Structuring International Contracts*, D. Campbell, (ed.), The Hague, Kluwer Law International, 1996, pp. 179–192.

[34] S.N. Ball, Work Carried out in Pursuance to Letters of Intent—Contract or Restitution, *L.Q.R.* 1983, 590.

[35] Article 2.1.15 Unidroit Principles 2004 endorses the principle of a qualified freedom of negotiators, which can be held liable for conducting or terminating negotiations in bad faith. A party is deemed to be acting in bad faith if it enters into or continues negotiations when intending not to reach an agreement with the other party. A party may also be liable if it deliberately or by negligence misleads the other party as to the nature or terms of the proposed contracts either by misrepresenting facts or by not disclosing facts, which, given the nature of the contract or the parties, should have been disclosed. The comment in this respect emphasizes that liability as a rule only covers reliance interests but not expectation interests and that disclosure obligations are situation-based (on the status of Article 2.15, see M. Suchankova, Les Principes d'Unidroit et la responsabilité précontractuelle en cas d'échec des négociations, *R.D.A.I.*, 1997, pp. 691–702; for a critical analysis pointing to the gaps regarding Article 2.15, see J. Hager, Die culpa in contrahendo in den UNIDROIT—Prinzipien und den Prinzipien des Europäischen Vertragsrechts aus der Sicht des deutschen bürgerlichen Rechts, in *Europäische Vertragsrechtsvereinheitlichung und deutsches Recht*, J. Basedow (ed.), Tübingen, 2000, pp. 67–84). The Principles of European Contract Law contain a rule analogous to Article 2.1.15 Unidroit in Article 2:301 but refer only to good faith, which may suggest a more objective approach to pre-contractual liability (for a comparison of both sets of rules, see B. de Coninck, Le droit commun de la rupture des négociations précontractuelles, dans *Le processus de formation du contrat—Contributions comparatives et interdisciplinaires à l'harmonisation du droit européen*, M. Fontaine (ed.)., Brussels, Bruylant and Paris, L.G.D.J., 2002, pp. 95–112). Article 6 (3) of the draft European Contract Code prepared by the Gandolfi group (Code européen des contrats, Livre Premier, Milan, Giuffrè, 2001, 576 pp.) provides that a party acts against good faith if it breaks off negotiations without cause under circumstances where the parties have considered essential elements of the contract as well as the possible conclusion of the contract, and the other party legitimately could rely on and expect contract formation.

On the legal status of negotiations in comparative law, see e.g., R.B. Schlesinger (ed.), *op. cit.*; International Chamber of Commerce, *op. cit.*; B. De Coninck, Le droit commun de la rupture des négociations précontractuelles, in M. Fontaine (ed.), *Le processus de formation du contrat, op. cit.*, pp. 17–137.

(b) Civil law countries all retain the principle of a possible pre-contractual liability, in spite of their differences concerning the basis for such liability. However, such classical theories have developed without taking into consideration the many varied documents currently examined.

The principal conclusion reached by the Working Group is that the negotiation of a contract, which is somewhat elaborate, often gives rise to the conclusion of various *contractual* agreements preliminary to the conclusion of the final contract or contracts.

These agreements, which constitute the true area of letters of intent, either deal with certain precise aspects of the negotiations or with the progressive formation of the future contract. Among the former are agreements relating to the exclusivity of the negotiations (Example 20), on the secrecy of information exchanged (Example 21), the time periods to be observed (Examples 22 and 23), on the achievement of preliminary studies or the reimbursement of resulting expenses (Example 24). As for agreements dealing with the progressive determination of the elements of the future contract, they may arise at different stages of the negotiation, in the form of either an initial and very general expression of an intent to contract (Example 8),[36] or the listing of general bases of the future contract and different aspects to be negotiated (Example 9), or a list of the results achieved halfway through the negotiation (Example 10), or of the partial results provisionally achieved while awaiting the result of parallel negotiations conducted with a third party (Example 11), or even the drawing up of the contract in almost completed form, some details scarcely remaining to be completed to perfect it (Example 13). A special place is taken by an agreement which, at an advanced stage of negotiations, authorizes one or other of the parties to start performance of the contract (Example 26).

Certainly not all negotiations, however substantial, give rise to the formation of such "contracts to negotiate." However, looking at the numerous situations that appear in the collected letters of intent, one must consider that the complexity of the negotiations, their length, the costs they involve, the need to coordinate various complementary negotiations, often lead the parties to provide their negotiations with an element of security by the insertion into a contractual framework of various obligations as to the procedure of the negotiations or of certain results already achieved.

How should one identify such passage from a legal no-man's land into contract law? The criterion is probably to be found in the will of the parties. Finding the existence of such a will is a matter of interpretation. In

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[36] In fact, as to the precise reservations contained in the text of Example 8, the Group hesitated, nonetheless, to see in this example the indication of a contractual obligation.

many cases, it appeared to the Working Group that the drafting of a special document, listing the terms of the agreement and signed by both parties (or of a letter addressed by one to the other, inviting the latter expressly to approve its contents) showed the existence of such a will to pass onto a contractual level.[37] It is here that the major effect of many letters of intent and other similar documents becomes apparent.

This approach was followed by the Commercial Court of Brussels in the *Dupuis* case. In spite of an agreement in principle concerning the takeover of its firm by G.B.L. and Hachette, Dupuis completed the operation with the Editions Mondiales. After a thorough analysis of this agreement in principle, the Brussels Court decided that this document created a *contractual* obligation to continue the negotiation in good faith. Under the circumstances, the Court considered that Respondent Dupuis did not act in good faith when brutally breaking off the negotiations in order to conclude the contract with a third party in violation of the agreement in principle. Such an agreement, according to the Court, constitutes a contractual basis for remedies in breach of negotiation.[38] Although it does not cite the report that the Working Group had published in 1977, this decision indirectly seems to have been inspired by it.

Another Belgian decision stated the opposite. In the *F.M.C. Corporation* case, the Court of Appeal of Brussels reversed a decision of the Brussels Commercial Court and gave a restrictive interpretation to a letter of intent: since it did not contain all the essential elements of a contract, the letter could provide no ground for contractual liability.[39]

More recently, an arbitral award rendered under the ICC Rules gave a very elaborate analysis of a memorandum of understanding. The tribunal distinguished two types of provisions. Some are considered final agreements, binding upon the parties. As to the other provisions, describing in general terms the parties' intention to conclude certain agreements, the tribunal "considers that when the parties agree upon general issues to be implemented by them at a later stage they cannot be released from their obligations to use their best efforts to ensure that such general issues become specific terms of contracts to be executed by the parties." Referring

[37] Certain members of the Group emphasised the difference in effect felt by parties between such documents and mere minutes of meetings.

[38] Comm. Brussels, June 24, 1985, *Journ. Trib.* (Brussels), 1986, 236: also see Comm. Brussels (injunctive proceedings), November 27, 1984, *Journ. Trib.* (Brussels), 1984, 721.

[39] Brussels, June 14, 1984, *Rev. Comm. Belg.*, 1985, 472. Concerning the *F.M.C.* case, see F. De Ly, Letters of intent under recent Belgian case law, case note under Court of Appeal of Brussels, June 14, 1984, Cour de Cassation, April 17, 1986 and Court of Appeal of Liège, October 20, 1989, *Dir. Comm. Int.*, 1990, pp. 707–711 and *R.D.A.I.*, 1991, pp. 566–568.

to Article 5.1.4 of the Unidroit Principles, the second paragraph of which establishes the scope of duties of best efforts in international contracts, the tribunal decides that ". . . the general description of the parties' intentions to reach agreements on certain issues contained in the MOU obligates the parties to exert their best efforts in order to have such intentions become definite terms of Contracts legally binding for each of them."[40] This award, thus, confirms that undertakings to negotiate embodied in letters of intent may in certain circumstances be of a contractual nature.[41]

(c) In this area, English law appears not to develop along the line of continental systems. English members of the Group have generally been more reluctant than their colleagues to recognize a contractual character to those various agreements attained during negotiations. It may be recalled that English law does not have a general theory of pre-contractual liability in torts. Perhaps English courts could admit the contractual nature of such agreements that deal with precise matters, such as exclusivity[42] or confidentiality, subject to the existence of consideration. At the present stage of development of English law, the idea of a contract to negotiate does not seem to be in conformity with dominant conceptions.

However, developments are not inconceivable in the middle term. English courts have always been sensitive to commercial practices, and the current development of letters of intent, together with the recent attention given to the concept of good faith,[43] could generate a new awareness and developments in the field. A member of the Group wrote: "In general, English courts are prone to give effect to the presumed intentions of parties and an intention to negotiate in good faith would appear to be a reasonable inference to be drawn of their intentions in signing such letter."

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[40] ICC award No. 8331, *Journ. Dr. Int.*, 1998, 1041, obs. Y. Derains, *Bull. Cour Int. Arb. CCI*, 1999, vol. 2, 67.

[41] See also the ICC award rendered on September 4, 1996, *Unif. Law Rev.*, 1997, 600, where the tribunal deliberately chose to apply a legal system that enforced an obligation to negotiate in good faith contained in a pre-contractual agreement. The law of the State of New York was chosen in that context; the tribunal also made reference to the Unidroit Priciples.

[42] In *Walford v. Miles* (1992) A.C. 128, the House of Lords has recognized such a contractual obligation, provided it is limited in time.

[43] It is possible that English case law will be influenced by the notion of good faith, but it may be integrated in the law of torts (perhaps through the concepts of negligence and even more of negligent misrepresentation), the law of quasi-contracts (restitution), the law of contracts (through the notion of implied contract terms, and for groups of contracts, through the concept of collateral contract) and some aspect of equity, such as promissory estoppel. On good faith in English law in general, see *Good Faith and Fault in Contract Law*, J. Beatson & D. Friedman (eds.), Oxford, Clarendon, 1995, 531 pp.; *Good Faith in Contracts*, R. Brownsword, N. Hird & G. Howells (eds.), Aldershot; Ashgate, 1999, 336 pp.

But he added: "For the moment, however, these are speculations, as there are no present indications that the law will develop along these lines in the short term."[44]

Two remarkable decisions nevertheless exemplify the traditional reluctance of English courts to assign any legal status to letters of intent. In the first case, Cleveland Bridge had informed British Steel of its intention to conclude a contract, and authorized its partner to start the work without any further delay. The court still considered that no contract had been created by the letter of intent, in spite of the fact that one of the parties had started to perform.[45] More recently, in *Walford v. Miles*,[46] the House of Lords considered that English law does not accept contracts obliging to contract and, therefore, no contracts to negotiate. The main reasons given are, on the one hand, the freedom of businessmen to decide whether or not to bind themselves and, on the other hand, the inherent uncertainties in the determination of contractual contents should the parties fail to agree. This decision has been widely criticized.[47]

(d) At stake in the above discussions is whether letters of intent may, in certain cases, be recognized to have a contractual status and lead to contractual liability in case of breach of the undertakings expressed, or whether they can be relevant only in terms of a possible liability in torts.

If a letter of intent were to be characterized as only relevant for tort purposes, such characterization would remain relevant. In this respect, letters of intent mark the seriousness of the parties' negotiations, record the points of agreement as well as the bases for further agreement. As such, they may constitute important elements of evidence for a tort claim against a party breaking off negotiations.[48] It remains that many letters of intent

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[44] See also *Chitty on Contracts*, 6th ed; 1989, No. 116, where the possibility that courts imbue letters of intent with a contractual character was already evoked.

[45] *British Steel Corp. v. Cleveland Bridge & Engineering Co.*, (1984) 1 All E.R. 504 (Q.B.).

[46] (1992) 2 A.C. 128.

[47] Cf. *Anson's Law of Contract, op. cit.*, pp. 65–67; N. Cohen, Pre-Contractual Duties: Two Freedoms and the Contract to Negotiate, in *Good Faith and Fault in Contract Law*, J. Beatson & D. Friedman (eds.), Oxford, Clarendon, 1995, pp. 25–56 and the references at note 41. For an analysis from the Italian point of view, see A. Mari & L. Simonetti, Agreements to Agree, agreements to negotiate ed obbligo precontrattuale di buona fede nel diritto inglese e nel diritto nord-americano (analisi comparativa alla luce di una recente sentenza della House of Lords), *Dir. Comm. Int.*, 1992, 601–629. Attention will also be drawn to the arbitral award rendered on September 4, 1996, according to which the obligation to negotiate in good faith would be enforceable according to the law of the State of New York (*Unif. Law Rev.*, 1997, 600).

[48] Compare E. Dirix, Le "gentlemen's agreement" dans la théorie du droit et la pratique contemporaine, *Rev. Dr. Int. Dr. Comp.*, 1999, pp. 242–244, who makes a distinction

also include undertakings that may be characterized as being contractual in nature, and thus, a significant qualitative difference may exist between any such letters of intent and those not containing contractual commitments, which are merely relevant from a tort perspective.

However, this distinction and attendant qualification only matters inasmuch as the rules governing contractual liability and tort liability respectively differ. This is, for instance, not the case in The Netherlands, which explains why Dutch law is not so much concerned about this characterization issue and why in that jurisdiction contractual, non-contractual and *sui generis* (i.e., a specific relationship between parties governed by good faith) can coexist without any problem.

(e) Whatever the applicable law, the situation is, of course, clearer when the drafters of a letter of intent have taken an express position as to the nature of their agreement. Thus, the wish to have some legal effect is sometimes expressly confirmed by the parties (Example 5). Sometimes, on the other hand, it is expressly denied (Examples 14, 15 and 17), or clearly excluded by the context (Example 18).[49] At other times, the parties insert a clause excusing them from any liability in the event of a breakdown of their negotiations (Examples 16 and 17).

A clause excluding all legal obligation (subject to contract), and all other formulae indicating the wish of the parties to place themselves outside the law, are recognized to be fully effective in English law.[50]

In American law, contract clauses have also been considered as valid, but their efficacy may be affected if contradicted by a party's conduct.[51] However, the application of such clauses is much more qualified in the United States than in England.[52]

This is demonstrated by the spectacular *Texaco v. Pennzoil* case in which Texaco was sentenced to pay what was then the highest award ever granted,

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between agreements in principle imposing contractual obligations and "pure" letters of intent which only give rise to liability in tort.

[49] See, however, the questions raised by the Group in the commentary on Example 18.

[50] See *Rose and Frank Co, v. Crompton Brothers Ltd.* (1925) A.C. 445; *Walford v. Miles* (1992) A.C. 128; Chitty, *op. cit.*, No. 79 and 92. Compare the different interpretations quoted by B. Hanotiau, M. Demideleer & N. Gerryn, Vers la conclusion du contrat: les éléments caractéristiques de la convention et les pouvoirs des négociateurs, *Assoc. belge des jur. d'entrepr.*, 1987, pp. 106–111.

[51] See the cases analyzed by W.H. Holmes, The Freedom Not to Contract, 60 *Tulane Law Rev.*, (1986), pp. 751–798.

[52] See B. Hanotiau, M. Demideleer & N. Gerryn, *op. cit.*, pp. 106–111.

13 billion U.S. dollars, reduced on appeals to one billion! After Pennzoil had launched a takeover bid against Getty, a *memorandum of agreement* was signed on January 2, 1984 between Pennzoil and Getty's two main shareholders, with the intent that the former firm merge with the latter. The agreement was signed "subject to approval by the Board of Directors (of Getty)"; approval was granted on January 4. The parties then announced the conclusion of an *agreement in principle* and added "the transaction is subject to execution of a definitive merger agreement." On January 6, after rapid secret negotiations, another notice announced the acquisition of Getty by Texaco. This was the beginning of lengthy proceedings. Pennzoil first tried in vain to obtain specific performance of the *memorandum of agreement* in a Delaware court. It then sued before Texas tribunals, seeking seven billion dollar damages from Texaco, plus an additional seven billion punitive damages, for the tort of having induced Getty to breach its contractual undertaking ("intentional interference with contractual relations").

The solution of the dispute depended upon the value given to the *memorandum of agreement*. The jury found this agreement valid, and sentenced Texaco to pay ten billion dollars damages and three million dollars in punitive damages. On appeal, damages were reduced to one million dollars.[53]

This case illustrates the relativity of *subject to contract* clauses in American law, as well as the limits to parallel negotiations and the risk a third party runs when knowingly interfering with ongoing negotiations. The irony in the Pennzoil case is that Texaco was punished, while Getty's shareholders escaped any sanction for lack of a basis for contractual liability.

Would a clause claiming to deprive an agreement of all legal effect be valid under civil law systems?

The Group expressed some doubts about its validity in French law (see commentaries to Example 14). The opinion was nevertheless expressed that the new Article 12 paragraph 4 of the French Code of Civil Procedure, which permits the parties to make characterizations of their relationships that are binding a judge, should also permit them to make effective declarations depriving any agreements they may have reached of any contractual effect.[54]

[53] *Texaco Inc. v. Pennzoil Co.*, 784 F2d 1133 (2d Cir. 1986). On this case, see U. Draetta, Criteri redazionali di littere di intento alla luce dei casi Pennzoil e SME, *Dir. Comm. Int.*, 1987, pp. 243–249, and from the same author, The Pennzoil Case and the Binding Effect of Letters of Intent in the International Trade Practice, *R.D.A.I.*, 1988, pp. 155–172; see also E. Chamy, L'affaire Texaco-Pennzoil et ses multiples développements au sein du système judiciaire américain, *Journ. Dr. Int.*, 1988, pp. 979–1006.

[54] Cf. B. Mercadal & Ph. Janin, *Les contracts de coopération inter-enterprises,* 1974, No. 43; F. Osman, *Les principes généraux de la lex mercatoria,* Paris, L.G.D.J., 1992, p. 58.

It has also been suggested that a distinction should be drawn between a situation where the apparent absence of any legal effect results only from the clumsiness or ambiguity of the expressions used to describe the parties' will (Examples 1 to 4), and a situation where draftsmen declare with complete clarity that the letter of intent shall have no legal effects.[55]

In France, courts also admit the validity of gentlemen's agreements and similar undertakings ("*engagements d'honneur*"), but a French judge does not consider himself automatically bound by the parties' expressed will if the facts are to the contrary.[56] A Belgian author drew up a systematic list of types of agreements that are outside the law, or which the parties consider so, with particular attention to letters of intent. This author considered that a judge must respect the parties' expressed will to remain outside the law, subject to public policy and mandatory provisions.[57] On the other hand, a Dutch study, with many comparative ramifications, notes that gentlemen's agreements are usually considered non-binding, which does not necessarily deprive them of all legal value.[58] On this point, the very expression that "the parties chose to remain outside the law" can be criticized, since the parties may certainly stipulate that their agreement cannot be qualified as a contract, but negligent behavior remains legally relevant, at least where tort liability is concerned.

As for a clause excluding liability, its effectiveness should generally be accepted, but subject to such qualifications as particular legal systems may apply. At least it appears that such a clause cannot free its author of the consequences of fraudulently breaking off negotiations.[59] One will note that the clause itself constitutes an agreement of a contractual character.

(f) Analyses of letters of intent are often based on an all or nothing model. Such documents are qualified either as contracts to negotiate or as non-contractual instruments, possibly relevant only with respect to tortious liability.

The above analysis has shown that international practice does not confirm such a simplistic division; the same instrument can include elements

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[55] On the tendency of businessmen to remain outside the realm of the law, see S. Macauly, Non-contractual Relations in Business. A Preliminary Study, 28 *Amer. Sociol. Rev.* (1963), pp. 55–67; L. Bernstein, Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry, 21 *Journ. of Legal Studies* (1992), pp. 115–157.

[56] See B. Oppetit, *op. cit.*, pp. 107–116.

[57] E. Dirix, Gentlemen's agreements en andere afspraken met onzekere rechtsgevolgen, *Rechts. Weekbl.*, 1985–86, col. 2119–2146; E. Dirix, *op. cit.*, pp. 223–245.

[58] B. Wessels, Gentlemen's Agreements Regulating Business Relations Under Dutch Civil Law, *Netherl. Int. Law Rev.*, 1984, pp. 214–254.

[59] Cf. *infra*, Chapter 7, pp. 384–385.

of both types. In recent years, drafting practice has developed two techniques that reflect this dual character of letters of intent.

The most common technique consists in inserting a specific clause in the letter of intent enumerating the provisions with contractual value. Confidentiality and exclusivity clauses frequently appear in such lists, as well as clauses concerning applicable law and dispute resolution (arbitration, forum selection). By specifying binding clauses, the parties indicate that they intend to be bound by them. Besides, if the negotiation fails, such clauses may serve functions similar to those of obligations surviving the contract.[60]

The other technique, less frequent, consists in dividing the letter of intent into two parts, one with non-binding elements and the other one with contractual provisions.

Such techniques demonstrate a definite sophistication of the drafting of letters of intent as well as a maturation of contractual practice.

2. *Contracts to Negotiate: Principal Legal Problems*

When negotiators specifically express agreement on the development of the negotiation process or some of its aspects and do not claim to stay outside the law, the interpreter, in many cases, will be in a position to discern contractual elements preceding the conclusion of the contract being negotiated.

If one accepts the appearance of such contracts in the course and context of negotiations, one must still set out (a) their contents, (b) the criteria for what constitutes a breach of contract and (c) the remedies open to an injured party in the event of wrongful non-performance. A few brief reflections will address the effect which letters of intent may have at a later stage, where negotiations have resulted in the conclusion of the contract (d).

(a) Contents. What obligations do such contracts, created in the course of negotiations, engender for the parties?

The answer is relatively straightforward so far as concerns the first group of such contracts, relating to certain specific aspects of negotiations.[61] Their purpose is often expressed precisely; e.g., not to enter into

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[60] Cf. *infra*, Chapter 13.

[61] In this respect some authors distinguish between temporary agreements and partial agreements; cf. J. Schmidt, *Négociation et conclusion de contrats*, Paris, 1982, No. 455–484; cf. also, from the same author, Preliminary Agreements in International Contract Negotiation, 6 *Houston J. of Int. Law* (1983), pp. 37–62, La négociation du con-

parallel negotiations with competitors, not to divulge confidential information revealed in the course of discussions, to follow the time limits provided for the various phases of the negotiation, to carry out preliminary studies or to share the burden of their costs in agreed proportions.

The problem is more complicated as regards agreements relating to the progressive elaboration of the future contract. Where a letter of intent sets out the agreement of the parties on certain clauses of their coming contract, the undertakings accepted are clearly not those of performing these clauses yet. This raises the question as to the effect of the agreement reached so far? From the discussions of the Group, the opinion emerged that the basic obligation assumed by negotiators who put their debates onto a contractual level is to continue negotiations in good faith, taking all necessary steps toward their completion.[62]

The content of such an obligation to negotiate in good faith, however, needs to be analyzed more precisely. The classical theory of *culpa in contrahendo* already refers to the requirement of behaving in good faith during negotiations. The expression *contracts to negotiate* that one may discover in some letters of intent should give such good faith a more substantial content. This content certainly does not have the same tenor depending on whether the letter of intent is issued at an initial stage of discussions or at a very late stage. The requirement to negotiate in good faith grows gradually along with the progress of the negotiations.

An initial common intent to seek agreement expressed at the start cannot involve more than an obligation to meet, and to engage in negotiations with a constructive attitude (compare Example 8, whose contractual character is doubtful). But where discussions have really started and have begun to produce certain results, a letter of intent, which records the agreement on the results so far achieved, seems to involve an obligation not to question these any longer, except by common agreement should this should become necessary due the progress of the discussions, or by developments in complementary negotiations with third parties, as in Example 11.

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trat international, *D.P.C.I.*, 1983, pp. 239–260, as well as L'évolution de la responsabilité précontractuelle en droit français, in G. Weick (ed.), *Entwicklung des Deliktsrechts in rechtsvergleichender Sicht*, A. Metzner, 1987, pp. 141–166. Another classification of preliminary agreements is found in M. Vanwijck-Alexandre, La réparation du dommage dans la négociation et la formation des contrats, *Ann. Fac. Dr. Liège*, 1980, pp. 34–39.

[62] For this argument see J. Van Uytvanck, La Pratique d'entreprises belges en matière de contrat international, in *Le Contrat économique international*, Bruxelles & Paris, Bruylant-Pedone, 1975, p. 397. But compare with doubts of Belgian practitioners regarding the real effect of letters of intent revealed in the same work by the inquiry of M. Verwilghen & F. Ravet-Gobbe, *id.*, pp. 355–356.

The nearer the issue of such a letter to the anticipated end of discussions, the more such a letter of intent imputes an obligation to accept the earlier results of the negotiations stated in the letter.[63] The obligation would seem to reach its highest level of strength where the letter of intent already authorizes a start in performance of contractual obligations while the contract itself is not yet concluded (Example 26).

The general obligation to negotiate in good faith, deriving from a contract to negotiate, involves also various duties such as to inform the other party correctly of the various elements relevant to it,[64] to refrain from making any clearly unacceptable proposals necessarily leading to the failure of further discussions, not to prolong negotiations by encouraging false hopes in the mind of one's partner after the decision to break off discussions has been taken.[65] It would seem also that even in the absence of any explicit clause, the obligation to negotiate in good faith imports certain of the duties that are sometimes the object of such special agreements as have already been mentioned (e.g., collaboration of each party in relation to the conclusion of negotiations within a reasonable time (compare Examples 22 and 28), respect for the confidential character of information received (compare Example 21), even perhaps an undertaking not to carry out parallel negotiations with third parties without the knowledge of one's partner (compare Example 20).[66]

Some of these obligations would appear to be imposed on negotiators, even in the absence of any contract to negotiate. In the tradition of romanistic countries they may be sanctioned by tort liability.[67] It has been recalled that *culpa in contrahendo* is also related to the requirement of behaving in good faith during negotiations. But where the relationship between the negotiators may be characterized as contractual, these obligations are stronger (the stronger the later the stage in the negotiations) and more substantial than merely to refrain from certain reprehensible conduct. Under such a characterization, the main obligation emerging from all these different facets of a contractual duty to negotiate in good faith, is to collaborate in search of a successful conclusion of the negotiations.[68]

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[63] Cf. J. Ghestin, *Traité de droit civil*, t. II, *Les obligations, Le contrat: formation*, 2nd ed., 1988, No. 240–242 who qualifies such undertakings as partial agreements.

[64] Compare M. de Juglart, L'obligation de renseignement dans les contrats, *Rev. Trim. Dr. Civ.*, 1945, pp. 1–22; F. Terré, Ph. Simler & Y. Lequette, *op. cit.*, No. 178–182; F. Kessler & E. Fine, *op. cit.*, pp. 404–405 (duties of disclosure); P. Engel, *Traité des obligations en droit Suisse*, 2d edition, 1997, pp. 187–188; B. Mercadal & Ph. Janin, *op. cit.* No. 30.

[65] See P. Engel *op. cit.* pp. 136–137.

[66] J. Van Uytvanck, *op. cit.*, p. 397.

[67] See B. Mercadal & Ph. Janin, *op. cit.*, No. 29–33.

[68] This approach was retained by the Commercial Court of Brussels, in the *Dupuis* case described above.

(b) Establishing Breach. The rules for establishing breach of contract are far from easy to determine in such a new subject matter. Furthermore, they will not necessarily be the same whatever the applicable law, the rules of contractual liability often present important differences from one country to another.

In French law it appears that the general obligation to negotiate in good faith is an obligation of best efforts,[69] each negotiator having to take all steps appropriate to achieve success in the negotiations. The undertaking is not that one will succeed but that one will do all one can to succeed. A breach, to be proved by one's partner, would consist of conduct contrary to that expected of a diligent and constructive negotiator.[70]

There is growing intensity in the requirement to negotiate in good faith as negotiations progress; correspondingly, the definition of breach also evolves: particular conduct, acceptable at the stage of a letter of intent issued at the beginning, will no longer be so when the parties have almost closed their negotiations.

It would appear that the results would not be very different in the common law, subject to developments towards recognizing a contractual character in certain undertakings expressed in letters of intent. An English member of the Group is of the opinion that breaches would then be evaluated by reference to the diligence required from a reasonable man put under the same circumstances.[71]

The best efforts nature of undertakings contained in letters of intent has been retained by a recent arbitral award, already mentioned above. A party was accused of having failed to contribute in good faith to the conclusion of an agreement envisaged in a memorandum of understanding. In order to characterize obligations to negotiate in good faith, the tribunal made express reference to Article 5.1.4 of the Unidroit Principles, the second paragraph of which defines the scope of obligations of best efforts: "The Arbitral Tribunal . . . rules that the general description of the parties' intentions to reach agreements on certain issues contained in the MoU

[69] On the distinction between the obligations as to the means and obligations as to the results (obligation de résultat), see *infra*, Chapter 4, pp. 218–222.

[70] See the proposal of Bâtonnier Lambert Matray that one should consider whether the conduct is manifestly wrong in *D.P.C.I.* 1976, pp. 478–480.

[71] Compare the brief allusion made to this problem by A.M. Dugdale and N.V. Lowe, Contracts to Contract to Negotiate, *Journ. Bus. Law*, 1976, pp. 34–35. In American law, cf. the suggestions made by the letter of R.D. McGrew, *D.P.C.I.* 1976, p. 482; compare E. Allan Farnsworth, Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations, 87 *Col. Law Rev.* (1987), pp. 217–294.

obligates the parties to exert their best efforts in order to have such intentions become definite terms of Contracts legally binding for each of them."[72]

However, certain aspects of contractual obligations derived from letters of intent appear to involve stronger obligations, as obligations to achieve specific results (Unidroit Principles, Article 5.1.4(1)). One may refer in this respect to commitments not to re-open matters already agreed upon, to observe the confidentiality of information provided, and not to enter into competing negotiations with third parties.

(c) Remedies in the Event of Breach. One of the signatories of a letter of intent breaches the obligation to continue the negotiations in good faith: he breaks off negotiations without further justification, or at least ceases constructive cooperation in search of an agreement. What are the remedies available to his partner?

1. Intervention of an Arbitrator or a Judge. The questions arises whether an aggrieved party can obtain an order from an arbitrator or a judge that the other party be obliged to resume the negotiation, or even to conclude the agreements that were to be negotiated. Even in legal systems permitting specific performance, this will hardly be possible. It is difficult to compel someone to resume negotiations. Also, no obligation to reach agreements on the envisaged contracts is conceivable, since the letter of intent only obliged negotiation in good faith, with no assurance of success. The most adequate remedy will normally consist of damages.

These principles have been confirmed in the *Dupuis* case.[73] Since Dupuis was held liable for a contractual breach for not having pursued the negotiation, the specific performance requested (i.e., transfer of the shares at stake to Claimants G.B.L. and Hachette) was denied, since an agreement in principle does not oblige concluding the contract, but only negotiating in good faith. The tribunal noted that the proper remedy would be damages, but those were not awarded since they had not been claimed. On the contrary, damages were granted by an arbitral award also mentioned above, as a remedy for the failure to have exerted one's best efforts towards the conclusion of an agreement envisaged in a memorandum of understanding.[74]

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[72] ICC Arbitral award No. 8331, *Journ. Dr. Int.*, 1998, 1041, obs. Y. Derains, *Bull. Cour. Int. Arb. CCI*, 1999, Vol. 2, p. 67.

[73] Comm. Brussels, June 24, 1985, *Journ. Trib.* (Brussels), 1986, 236; also see Comm. Brussels (injunctive proceedings), Nov. 27, 1984, *Journ. Trib.* (Brussels), 1984, 721.

[74] ICC arbitral award No. 8331, *Journ. Dr. Int.*, 1998, 1041, obs. Y. Derains, *Bull. Cour Int. Arb. CCI*, 1999, Vol. 2, 67; comp. J. Schmidt-Szalewski, La force obligatoire à l'épreuve des avant-contrats, *Rev. Trim. Dr. Civ.*, 2000, pp. 29–38.

Could one not imagine that, in legal systems familiar with such a mechanism, the failing party could be obliged to resume negotiating loyally under threat of a judicial penalty (a so-called *astreinte*; see Unidroit Principles, Article 7.2.4)? Such remedy would hardly be productive: the failing negotiator can perhaps be compelled to resume negotiations, but not to bring them to a successful end.

Considering the impossibility to oblige the failing party to offer constructive cooperation, another remedy comes to mind: could a third party be entrusted with undertaking the functions of the contesting parties in order to finalize the agreement? If need be, the letter of intent could provide for the intervention of an arbitrator in order to complete the contract in the event of disagreement between the parties (see Example 5).[75] Failing this, might not a judge make good the default of one of the negotiators ?

Generally speaking, the answer is no. A contract can only result from the mutual agreement of the parties and a judge cannot substitute for this.

But might the situation not be different if the breach occurs at an extremely advanced stage of the negotiations, where an agreement has been reached on the principal elements of the contract and only secondary points remain to be settled?[76] The Swiss Federal Code on obligations contains, in this respect, a remarkable provision: "If the parties have reached agreement on all principal points, the contract is to be considered achieved, even where secondary points have been reserved. In default of agreement on the secondary points, the judge is to settle them taking into account the nature of the matter" (Article 2).[77] The German *Bürgerliches Gesetzbuch* (§ 154) as well as the Unidroit Principles (Article 2.1.13) arrive at the opposite solution.

The question has to be examined as part of the general and very complex discussion between essential, substantial and accessory elements of a

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[75] The intervention of arbitrators in connection with the formation of contracts was discussed by E. Bagliono & G. D'Amely Melodia at the IVth International Arbitration Congress (Moscow, 1972). Also see B. Mercadal & Ph. Janin, *op. cit.*, pp. 26–27. Compare with the evolution of the role of arbitration discussed in relation to hardship clauses, *infra*, Chapter 9, pp. 490–491.

[76] Here the situation is envisaged where the parties had shown an intention to negotiate these secondary points. It is, in fact, extremely frequent for parties to fail to negotiate these minor aspects of their agreements relying upon the rules implied by law; in such cases the conclusion of the contract is not in doubt (cf. R.B. Schlesinger, *op. cit.*, I. pp. 85–86).

[77] See P. Engel, *op. cit.*, pp. 156–157; see also G. Bernini, Techniques for Resolving the Problems in Forming and Performing Long Term Contracts, *D.P.C.I.* 1976, p. 497. The Algerian Civil Code (Ordonnance No. 75–58 of September 26, 1975) contains a similar provision (Art. 65).

contract. In general, legal systems require the parties' agreement on the essential elements in order that the contract be concluded, but they consider that the lack of agreement on accessory points does not prevent formation of the contract. The intermediate zone is that of elements, which may appear as secondary, but about which parties had accepted the necessity of an agreement before the contract could be completed (such elements thus becoming substantial). In this context, taking into account the solution given by the applicable law, one may envisage a possible determination by an arbitrator or a judge of the secondary points upon which parties have not been able to agree.[78]

2. *Assessment of Damages.* The cases where the completion of negotiations that have broken off can be entrusted to a third party, arbitrator or judge, are probably very rare. In most cases, particularly if discussions were not very advanced, the only remedy of the party injured by an unjustified breach is to claim damages.[79] But how should they be quantified? Should one only consider the damage flowing from the cost of the abortive negotiations, or may one also take into account the loss of profit that would have resulted from the contract?

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[78] On these distinctions between essential, substantial and accessory elements in comparative law, cf. C. Delforge, *op. cit.*, pp. 430–437. It is often stated (we did so ourselves in the first edition of this book, p. 42) that Article 2 of the Swiss Code of Obligations would apply the theory of *punctatio,* contrary to § 154 of the German Civil Code, which would reject that theory. This is a misunderstanding (cf. C. Delforge, *op. cit.*, pp. 461–474). These two provisions take opposite positions on the classical question of lack of agreement on secondary elements made substantial by the parties. On the other hand, the theory of *punctatio* considers that a contract does not necessarily come to existence at once, but in successive layers, along with the progress of negotiations (see J. Carbonnier, case note under Cass. fr., March 24, 1958, Jur. Class. Pér., 1958, No. 10868; G. Farjat, *Théorie des obligations,* 1975, pp. 130–131; G. Schrans, *op. cit.*, pp. 23–25; J. Schmidt-Szalewski, Les letters d'intention, *I.B.L.J.*, 2002, pp. 266–270); it is meant to be an alternative to the traditional view according to which a contract necessarily results from the acceptance of an offer. This approach is subject to growing criticism (cf. J. Bonell, The Vienna Convention on International Sale of Goods, in *Formation of Contracts and Contractual Liability,* Paris, International Chamber of Commerce, 1990, p. 159; E.A. Farnsworth, General Report, in *General Formation of Contracts . . . , id.*, p. 17; M. Fontaine, Offre et acceptation, approche dépassée du processus de formation des contrats?, in *Mélanges offerts au Professeur P. van Ommeslaghe,* Brussels, Bruylant, 2000, pp. 115–133). Thus, properly understood, the theory of *punctatio* casts an even more interesting light on the phenomenon of letters of intent.

A possible intervention of an arbitrator or a judge to complete the elements of a contract on which the negotiation has failed should not be confused with the problems related to elements of a contract the determination of which was deliberately postponed until performance (contracts with open terms).

[79] Cf. M. Vanwijck-Alexandre, La réparation du dommage dans la négociation et la formation des contrats, *Ann. Fac. Dr. Liège,* 1980, pp. 24–34.

The letter of intent may provide an answer to the question by an express clause fixing the amount of the compensation (Example 25), or excluding all indemnification (Examples 16 and 17, subject to the reservations mentioned above).

In the absence of a contractual provision, what should be decided and on what grounds? The answers are both diverse and uncertain in comparative law.[80]

Since Jhering, German theory distinguishes between negative damages, (*Vertrauensschaden*) and positive damages (*Erfüllungsinteresse*). The former are intended to put the injured person back in the same place where he would have been if no negotiation had even occured; the latter seeks to compensate for the lack of performance of the contract.[81] A similar distinction exists in the common law between reliance interest and expectation interest.[82]

Culpa in contrahendo generally will lead to a remedy for negative damages.[83]

The obligation assumed by the signatories of a letter of intent is not to perform the contract that remains to be concluded. The obligation assumed is not even to reach an agreement, but to take all steps towards this end. Thus, it would appear difficult to punish the wrongful breach by compensation calculated by reference to the profits lost on a contract to be concluded. If the sanction must correspond to the obligation, a failure to negotiate in good faith should rather be followed by the grant of negative damages, seeking to return the partner to the situation that it would have been in if it had not entered into negotiations with the party responsible for the breach.[84]

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[80] See R.B. Schlesinger, *op. cit.* I, p. 89 note 13.

[81] On this distinction, see, e.g., K. Larenz, *Allgemeinen Teil des deutsches Rechts,* 7th edition, 1989, p. 388; see also J. Ghestin, *op. cit.*, No. 943. The distinction is also to be found in Italian law in the application of Article 1337 of the Civil Code.

[82] The distinction found its way in American law after the article of L.L. Fuller & W. Purdue, The Reliance Interest in Contract Damages, 46 *Yale Law J.* (1935), pp. 52–98. Nowadays, it is a favorite theme of discussion of the *Law and Economics* school (cf. for instance R. Cooter & Th. Ulen, *Law and Economics,* 2nd ed., 1996, pp. 172–180, 203–211).

[83] But certain texts would limit the negative damages to the amount (which can be lower) of the positive damages. See J. Esser & E. Schmidt, Schuldrecht, Vol. I/2, 7th edition, Heidelberg, Müller, 1993, p. 142.

[84] Compare F. Kessler & E. Fine, *op. cit.*, p. 405.

Such damages will essentially comprise the cost of the negotiations: time wasted, the costs of travel and sustenance, preliminary studies, etc. Negative damages can, however, also cover other elements, such as the possible harm to commercial reputation resulting from the circumstances under which the negotiation was broken off, the loss resulting from the impossibility to perform an undertaking assumed in good faith towards a third party on the expectations reasonably inferred from the letter of intent, or even the benefit lost from a transaction, which could have been concluded with a third party, if the aggrieved party had not believed it was bound by the failed negotiation. Negative damages are not necessarily inferior to positive damages.

However, concerning some of the indirect losses that have just been described, one cannot underestimate the very delicate character of evidential matters, due to the complexity and the uncertainty of the type of negotiations under discussion. The aggrieved party may experience much difficulty in proving that a similar contract could have been concluded with a third party. On the other hand, the victim's own imprudence may lead to diminish or even suppress any obligation to compensate, e.g., if inconsiderate commitments had made towards third parties at a premature stage of the negotiations.

Compensation due in case of wrongful breach of negotiations by the signatory of a letter of intent where one can recognize a contract to negotiate should thus correspond to negative damages, subject to the above reservations. It would only appear possible to envisage positive damages, compensation for the profit lost from the abortive contract negotiations at an extremely advanced stage of negotiations, in cases where one might sometimes consider that the contract is already concluded and that a judge might complete the final secondary provisions (see above).[85]

The distinction between positive and negative damages, enlightening for the present discussion, appears to be admissible even in the domestic systems that have not yet adopted such distinction, such as French or Belgian law. In the common law, the similar distinction between reliance and expectation interests has been referred to. In *Walford v. Miles*, the House of Lords sentenced the author of the wrongful breach to compensate for the loss resulting from the direct costs of the failed negotiation.

[85] A Swiss member of the Group was more open to the idea of an award of positive damages, "when the fault committed is particularly characterized and mostly when it occurred at a moment when the greater part of the essential elements of the contract were already agreed upon." This position is facilitated, under Swiss law, by Article 43 of the Code of Obligations, which provides that "The judge determines means as well as extent of indemnification due, according to the circumstances and the seriousness of the fault."

Whatever the applicable law, particular aspects of the problem of damages arise where the fault consists of the breach of a specific obligation such as to respect the confidential character of information exchanged (Example 21). The damage suffered by a company whose business secrets have been disclosed to a third party should also be compensated subject to the problems of proof as to the establishment of the amount of the loss. On the other hand, where one of the parties has been authorized to start the work (Example 26) the damages flowing from the wrongful breach of discussions by the other party should also bear in mind the injury arising from the wholly wasted efforts of these first phases of the abortive contract.[86]

One final remark about damages. The above discussion presupposes that the wrongful breach of negotiations has led to legal action. Such a situation may be theoretical. A claim for damages, however legally justified, may be unthinkable from a commercial point of view, or because of the other party's standing. This observation is, of course, not specific to letters of intent.

(d) Effect of letters of intent after the conclusion of the contract.

The negotiation, which was the occasion of issuing different letters of intent, has come to a successful end: the definitive contract has been concluded. Do pre-contractual documents then lose all effect? This is not always the case.

Firstly, the contract may later be avoided. One mainly thinks of a party having made a mistake in contracting, which could have been caused by the other party failing to give adequate information. In such a case, a letter of intent can provide a context permitting to determine whether or not the mistake was essential and in what measure damages should be granted.[87] The problem has so far hardly been analyzed but it deserves attention.[88]

Secondly, the letter of intent may be relevant in cases where the contract remains valid, but non-performance of a pre-contractual duty serves as a basis for an action in damages to compensate the aggrieved party. One can think of pre-contractual obligations of information, advice, fair dealing or confidentiality, the breach of which is generally not fundamental and does not lead to the avoidance of the contract.

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[86] Cf. on this subject R.D. McGrew *op. cit.* p. 481.

[87] M. Vanwijck-Alexandre, La réparation du dommage dans la négociation et la formation des contrats, *Ann. Fac. Dr. Liège*, 1980, pp. 61–71.

[88] For a critical appraisal of the application of the concept of good faith in cases of defective consent, cf. B. Jaluzot, *La bonne foi dans les contrats, Etude comparative de droit français, allemand et japonais,* Paris, Dalloz, 2001, pp. 372–379.

One can also consider whether letters of intent may not serve as means to interpret the contract. The contracts to negotiate, which may have been concluded, have, of course, exhausted their purpose. But could not letters of intent, in case of subsequent disputes, help interpret the contract that they helped to prepare?

Some members of the Group thought they could discern, in this respect, a general contrast between French law, favorable to the consideration of pre-contractual documents for the purposes of interpretation[89] and English law, depriving of any effect all that precedes the conclusion of the contract.[90] Other members considered, however, that an English judge will not always remain indifferent to the interpretative value of a pre-contractual document.

The parties can consider this question in drafting their definitive contract, either by providing that earlier documents should be incorporated in the contract[91] or, by stipulating that the provisions of the definitive contract shall supersede and replace everything that went before.[92]

Finally, mention will be made of the possible role of letters of intent in a context involving several consecutive or parallel contracts. Pre-contractual agreements may be preliminary not to a single final contract but to a group of contracts. What is the situation if some of these contracts are concluded, but not some others? Letters of intent may here be invoked to demonstrate that the group was considered as an indivisible whole and that separate contracts cannot have any effect when there is no full agreement. A means exists to reduce the legal insecurity that could derive from this situation: it will be suggested in the following recommendations.

IV. ADVICE TO NEGOTIATORS

The study and discussion of the collection of 100 or so letters of intent have permitted us to sketch some legal observations. Our meetings have also brought to light a series of dangers to which the draftsmen of letters of intent are not always attentive in practice, as well as a group of suggestions that may be helpful to improve the use of pre-contractual documents.

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[89] Cf. J. Ferraris, *Le rôle des documents précontractuels dans l'interprétation par le juge du contrat*, Paris, Publibok Université, 2003.

[90] In support of this argument, see Ph. Kahn, *op. cit.* p. 187. Cf. *infra*, Chapter 3 concerning interpretation clauses, pp. 106–114.

[91] Cf. *Trollope & Colls v. Atomic Power* (1962) 3 All E.R. 1035.

[92] Cf. *infra*, Chapter 3, pp. 132–145. Cf. also Ph. Kahn, *op. cit.* pp. 187–189; E.H. Hondius, De "entire agreement" clausule: Amerikaanse contractsbedingen in het Nederlandse recht, in *Recht als norm en als aspiratie, Nijmegen*, 1986, pp. 24–34.

1. Most of the letters of intent examined showed a number of serious or minor drafting errors, such as would cause inevitable difficulties of interpretation between the parties in the event of dispute. A typical illustration has been given (Example 12). A major reason for this situation seems to be the fact that letters of intent are often drafted by non-lawyers, e.g., by engineers or by the sales department of the company. These persons, untrained in legal terminology, use expressions from current language lacking in precision, and even in certain cases, special terms which they have created and of which they alone know the sometimes surprising nuances (some sales departments, for example, introduce subtle distinctions between agreement, contract, order, etc.). The ambiguities thus created can have disastrous consequences. The first, and essential, advice is that the legal department should always be present at the drafting of pre-contractual documents, or that it should at least provide the non-legal negotiators with precise instructions about the expressions to be used or avoided.
2. The ambiguity of some letters of intent flows from another cause. The draftsmen seek to get a document accepted that binds them as little as possible while binding their partner. Such a purpose necessarily leads to equivocal texts. The group considers that there is little to be gained from such a play, which furthermore incurs the risk of creating many unfortunate side effects by the inherent uncertainties. It is always preferable to express, as clearly as possible, what is to be binding and what is not.
3. If one wishes not to be bound, while intending nevertheless to establish some document recording the progress of negotiations, it is preferable to say so, either by use of an expression such as the English phrase "subject to contract" (Example 14), always bearing in mind the doubts as to its effects under some other legal systems, or by excluding the imposition of damages in the event of breach (Examples 16 and 17). But one should not forget that even in the absence of any legal obligation, a letter of intent involves the reputation of the firm, and that the non-legal consequences of a denial can be just as serious as the legal consequences avoided (damage to commercial credit, breaking down of business relationships, etc.).
4. If one expects the letter of intent to give rise to certain obligations, it is better to express precisely the purpose of those obligations: not questioning again, without good cause, the results already achieved, not entering into parallel negotiations with third parties so long as the negotiations between the parties continue. It is also very desirable to specify the consequences of potential breaches, in particular the quantification of damages. The negotiators can also provide for the appointment of an arbitrator to settle certain

incidental clauses of the contract in the event of differences between the parties.

5. An interesting suggestion made by one member of the Group would be to stipulate at the start of the negotiations that the various pre-contractual documents will not be binding unless and to the extent that this should be expressly stated.
6. A number of the documents examined illustrated the importance of a set procedure for the negotiations, in particular so far as concerns fixing time periods for various phases. A clause covering the confidentiality of information exchanged seems necessary in certain cases.
7. The definitive contract ought to contain a clause relating to the letters of intent and other documents that have preceded it, either to establish their value for interpretation or to deprive them from the start of any legal effect.
8. If negotiations lead not to a single contract but to a group of contracts, the risk exists that after the conclusion of some of these contracts, completion of some others would not succeed. Letters of intent should be drafted in a way that would prevent one partner from claiming that the concluded contracts had already enter into force. A safer technique consists in creating a relay between the letters of intent and the different final contracts: a frame contract enumerating the different contracts to be concluded and expressing their necessary interdependence.[93]
9. Finally, the problem of which law should apply should not be ignored by the negotiators, for the legal effect of the various stages in the conclusion of the contract is not precisely the same from one country to another.

V. CONCLUSION

The collection and discussion of a substantial file of pre-contractual documents allowed the Working Group to appreciate the importance and variety of the phenomenon of letters of intent and other pre-contractual documents. The wealth of information, which was procured during the research project, had not been revealed by the traditional studies on the formation of contracts. Legal theory on negotiations has made substantial progress during the last century, but the material brought together here suggests that much remains to be done. Where the negotiations are long and difficult, the development of the future contract is itself often anticipated by the conclusion of a series of prior contracts, which record progressively the results achieved, or which organize the various aspects of the negotiations.

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[93] Cf. *supra*, the footnote under Example 12, another application of the frame-contract technique.

The study of such contracts gives rise to thorny problems, e.g., the extent of the obligations assumed, the establishment of breach or the fixing of damages.

The legal observations set forth above is a first attempt, which should be carried further on the basis of more substantial comparative law research.

CHAPTER 2
RECITALS IN INTERNATIONAL CONTRACTS

I. INTRODUCTION

A large number of contracts, particularly those dealing with international trade, begin with so-called "recitals." The parties to such contracts use recitals to set out a series of statements that they regard as useful before approaching the body of the contract. Often, the parties introduce themselves and state their respective qualifications. They describe the purposes of their contract and the circumstances that have brought about their collaboration. The history of their negotiations is sometimes given. Recitals record a wide variety of statements and acknowledgements. A transitional formula then leads to the contract itself.

Here is a first example:

> "M. is specialised in international Project Managership and contracting in the Turnkey Engineering field and wishes to further expand its activities by means of association with P. to enable both Companies to benefit from the possible introduction of the . . . Filter to the . . . Mining and Metallurgical Industries.
>
> "With this purpose in mind, M. has approached P.
>
> "The P. Group is active in the international engineering design and contracting industry, particularly those concerning plants of a Metallurgical nature and incorporating applications of the . . . Filter.
>
> "Therefore, it would appear that the above-mentioned Groups have a common interest of forming a joint venture in order to promote the P. Filter application in . . .
>
> "Therefore, the following has been agreed upon: . . ."

Although recitals occur widely, their legal implications appear to have been given little attention until now.[1]

[1] Subject to what will be said *infra*, p. 86 regarding English law, another extensive study can be referred to: F.W. Grosheide, De considerans in internationale commerciële contracten, in *Molengrafica, Eenvorming en vergelijkend privaatrecht*, Lelystad, Vermande, 1991, pp. 295–324. There are however some references to recitals in certain works for

The classical theory of contracts says nothing whatever about recitals. Should this silence be taken to mean that recitals have no legal implications? This would indeed be surprising if one bears in mind the growth since the 19th century in legal literature on the legal status of contract negotiations and the various legal effects that have come to be attributed to them. In the preceding chapter, a variety of situations giving rise to legal implications was discovered concerning letters of intent.[2] In the case of recitals, one reaches the threshold of the contract. There has been a meeting of minds and it is in the very document, which records their agreement, that the parties feel the need to describe some of the circumstances surrounding that agreement. It would be paradoxical if recitals were to be without any legal implications when such implications are recognized in certain aspects of the pre-contractual negotiations.

The study of recitals is made difficult by its novelty. We begin with a description of how recitals occur in practice. The analysis is based on some 200 examples of recitals collected by the Working Group (Section II). The second part of the study attempts to put forward some suggestions on the legal implications of recitals; after drawing parallels with similar but better known legal concepts, we point out the different ways in which the contents of recitals appear capable of affecting the legal position of the parties to the contract (Section III). Finally, we offer some advice to negotiators (Section IV).

II. RECITALS IN PRACTICE

A. Frequency of Occurrence

Recitals exist in a considerable number of contracts. An inventory made by a member of the Group of a representative sample of his firm's contracts showed the occurrence of recitals in 85 percent of cases! Recitals are not specific to international contracts,[3] but they have undergone considerable development in this area. Recitals introduce contracts of all types: sale and purchase, distribution, franchise, leases, agency, loan, pledge, transfer of technology, industrial construction, joint ventures, settlement

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practitioners, e.g., in J.M. Deleuze, *Le contrat international de licence de know-how,* Paris, 4th ed., 1988, No. 60; J.A. Boon & R. Goffin, *Les contrats "clé en main,"* Paris, Masson, 1981, No. 37; D. Ledouble, *L'entreprise et le contrat,* Paris, Litec, 1980, No. 105; D. Blanco, *Négocier et rédiger un contrat international,* Paris, Dunod, 1993, p. 98; J.M. Mousseron, *Technique contractuelle,* 2nd ed., Paris, Francis Lefebvre, 1999, pp. 171–173.

[2] Cf. *supra,* pp. 5–30.

[3] Insertion of recitals is characteristic in legal documents with a certain degree of solemnity, such as notarized documents (P. Watelet, *La rédaction des actes notariés,* Brussels, Larcier, 1975, p. 58)) or deeds (Odgers, *Construction of Deeds and Statutes,* 5th ed, 1967, pp. 149–160).

agreements, etc. Recitals are particularly frequent in contracts where the parties feel the need to give some explanation, notably because the pre-contractual negotiations have been long and difficult or because the contract relates to an original and complex transaction, especially if the transaction is to be implemented over a certain length of time.

The frequent occurrence of recitals explains why practical guides to contract drafting refer to them. Thus, the U.N. Economic Commission for Europe's Guide on the Transfer of Know-How states that recitals can serve as an aid to interpreting the parties' obligations in the event of a dispute.[4] The WIPO Guide describes the practice of including recitals, their significance and content in agreements for the licensing or transfer of technology.[5] UNCITRAL's Guides on International Contracts for Construction of Industrial Works and on International Countertrade Transactions state that recitals can contain certain statements instrumental to entering into the contract, defining the purpose of the contract and the context of its conclusion.[6]

On the other hand, it is noteworthy that standard contracts published by the International Chamber of Commerce[7] and the standard contract on International Sales of Perishable Goods prepared by the International Trade Centre[8] do not include recitals, while the new FIDIC contracts[9] have

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[4] U.N. Economic Commission for Europe, *Guide for Use in Drawing Up Contracts Relating to the International Transfer of Know-How in the Engineering Industry*, 1970, No. 24; J.M. Deleuze, *op. cit.*, No. 60.

[5] WIPO, *Licencing Guide for Developing Countries*, 1977, No. 124–127.

[6] UNCITRAL, *Legal Guide on Drawing Up International Contracts for Construction of Industrial Works*, New York, 1988, p. 49; UNCITRAL, *Legal Guide on International Countertrade Transactions*, 1993, p. 47.

Although entitled "Preamble," Article 1 of the general conditions issued by the U.N. Economic Commission for Europe, appears to be of a different nature. Article 1 forms part of the body of the contract and provides that the conditions are to apply unless both parties expressly agree otherwise in writing. (See notably conditions 188A).

[7] ICC Model Commercial Agency Contract, ICC Publication No. 496, Paris, ICC Publishing, 1991; ICC Model Distributorship Contract, ICC Publication No. 518, Paris, ICC Publishing, 1993; ICC Model International Sale Contract (Manufactured Goods intended for resale), ICC Publication No. 556, Paris, ICC Publishing, 1997; ICC Model Occasional Intermediary Contract, ICC Publication No. 619, Paris, ICC Publishing, 2000; ICC Model International Franchising Contract, ICC Publication No. 557, Paris, ICC Publishing, 2000.

[8] Model Contract and Users' Guide, International Commercial Sale of Perishable Goods, International Trade Centre (UNCTAD/WTO) 1999, 78 pp.

[9] Conditions of Contract for Construction (new Red Book), Lausanne, FIDIC, 1999; Conditions of Contract for Plant and Design-Build (new Orange/Yellow Book), Lausanne, FIDIC, 1999; Conditions of Contract for EPC Turnkey Projects (Silver Book),

only very short ones. This can be explained by the nature of these contracts, which aim at standardization, whereas recitals hardly fit such a purpose. The lack of mention of the possibility of drafting recitals can also be explained by the fact that some standard contracts are meant to be used in specific sectors such as commodities, perishable goods or products manufactured for sale, where contracts are not subject to lengthy negotiations.

B. Form

Recitals occur most often after a commencement introducing the parties to the contract:

> "This agreement is made between Consolidated Industries, Inc., hereinafter called Licensor, a corporation organized under the laws of Delaware, United States of America (United States), and having its principal offices in the United States, and Gas N.V., hereinafter called Licensee, a naamloze vennootschap organized and existing under the laws of the Kingdom of the Netherlands (Netherlands) and having its residence and principal offices in the Netherlands.
>
> "Witnesseth:
>
> "Whereas, . . ."

Sometimes, recitals bear a title: (*Preamble, Exposé des Motifs, Preliminary, Recitals, Präambel, Premesse*, etc). In contracts drafted in English, the recitals are often introduced by the word *Witnesseth*, as in the above example.

Generally, each paragraph of recitals begins with the words *Whereas*, or in French *Attendu que* or *Considérant que*.

Often, recitals end with wording that leads into the beginning of the contract. Here are some typical examples:

- "now, therefore in consideration of the premises and of the mutual agreements hereinafter contained, Licensor and Licensee do hereby agree as follows: . . ."
- "now, therefore, it is hereby agreed as follows: . . ."
- "en foi de quoi, il a été convenu de ce qui suit: . . ."

Lausanne, FIDIC, 1999. The standard form, which incorporates FIDIC conditions into the contract, starts with the following recitals: "Whereas the Employer desires that the Works known as . . . should be executed by the Contractor, and has accepted a Tender by the Contractor for the execution and completion of these Works and the remedying of any defects therein."

C. Length

The length of recitals varies considerably, from a few lines to several pages. Here is an example of a particularly brief recital:

> "Whereas, pursuant to arrangements made by X incorporated and Bank of Z Limited (hereincalled the Managers), the Banks, subject to the terms and conditions herein set forth, are willing to make loans available to the Borrower in a maximum aggregate principal amount of U.S. $ . . .
>
> "Now, Therefore, it is agreed: . . ."

Such brevity is fairly exceptional. Most recitals vary in length depending on the complexity of the circumstances surrounding the contract, and also on the verbosity of the contract's draftsmen and their desire to set out some explanations before entering into the contract.

D. Contents

What do recitals contain? Although their contents vary considerably, it is possible to categorize the types of subject matter most frequently encountered. The following account simply describes those different types; legal issues will merely be identified and will be discussed later in the second part of this study.[10]

1. Attributes of the Parties

Although the parties to the contract will perhaps have already been identified in the commencement of the contract, recitals very often contain a more detailed description of their respective skills and attributes:

- "whereas, A, through the operation of its subsidiaries and affiliates located in 22 countries in the world, has accumulated and is accumulating valuable experience and know-how in the business of, among other things, renting various kinds of television, video tape recorders and other similar and related merchandises to individuals, hotels and other customers;"
- "whereas, B and C each possess valuable information regarding the market situation relating to television, videotape recorders and similar and related merchandises and the rental business related thereto: . . ."
- "whereas, A is in the business of selling food products to end consumers in . . . and wishes to establish facilities for the production

[10] See *infra*, pp. 87–100.

and bottling and/or canning of fruit and similar drinks (hereinafter referred to as the Facilities);"

- "B is in the business of manufacturing and selling fruit juices, soft drinks, fruit concentrates and syrups in Europe and in other countries but is not in a position to market its finished products in Arabian countries;"
- "C is in the business in the Middle East and Africa of developing and managing complete industrial projects including the provision of technical and general management assistance to such projects and wishes to cooperate closely with above mentioned partners with respect to the construction of, and the transfer of technology to, the Facilities; . . ."

Often there is distinct emphasis of the particular attributes of one or the other of the parties:

- "whereas, Licensor is now and it and its predecessors for many years have been engaged in the business of designing, manufacturing and selling office plate holding devices, . . . ;"
- "Licensee is among the world leaders in the business of licensing know-how and patent rights for the design, construction and operation of . . . plants . . . ;"
- "considérant que X possède une expérience très développée dans la fabrication mécanique et dans la commercialisation d'articles de . . . ;"
- "A, constructeur de matériel textile, d'une part possède un réseau commercial important dans le monde entier et est donc, de ce fait, bien placé pour recueillir des demandes d'installations de fils ou fibres chimiques, . . ."

Such flattering appreciation is not always without ulterior motive. In many instances, it is initiated by the other party and doubtless the party that is the object of the flattery is unable to refuse the compliment. Below we shall deal with the repercussions that flattering words in the recitals can have on the parties' level of liability under the contract.[11]

In some cases, the opposite occurs and it is the party that is the object of the eulogy who requires its inclusion so as to justify any harsh provisions that it has forced the other party to accept. Such is the case in a Franchise Agreement containing the following:

> "Considérant que X possède une position prépondérante en matière de création de chaussures de femmes et dispose d'importants moyens de production, . . .

[11] See *infra*, pp. 93–94.

"Considérant que X a créé, en France et à l'étranger, des magasins de qualité indiscutable, installés dans des quartiers prestigieux et dont l'existence favorise le renom de ses propres marques, ainsi que de celles commercialisées dans ces points de vente,

"Considérant que le franchisé est conscient des avantages que peut lui procurer une plus étroite collaboration avec X, . . ."

Conversely, a party to a contract may wish to emphasize its own limitations so as to highlight the other party's responsibilities.

"Considérant que la société X n'est pas initiée à la technique informatique,"

2. *The Parties' Objectives in Entering Into the Contract*

Another topic frequently dealt with in recitals is the objectives sought by the parties at the time of entering into the contract. Here are several examples:

- "whereas, the Parties are desirous of participating in the execution of the Project, and, accordingly, wish to jointly prepare and submit to the Customer a Tender for the Project, and thereafter, if the Tender is accepted by the Customer, to execute the Project in collaboration jointly and severally towards the Customer, . . ."
- "whereas A and B desire to rationalize the production and operation of their respective mills so as to permit each mill to concentrate its production on grades of paper best suited to its equipment, to obviate short runs, and to effectuate other economies in the operations of both companies; . . ."
- "Attendu que les objectifs essentiels visés par cette collaboration sont: la mise au point et l'adaptation en commun de matériel textile mettant en œuvre la technologie la plus récente et la plus performante;
  la coordination des moyens de recherches de chaque Partie, afin d'abaisser le coût de ces recherches et d'en augmenter l'efficacité;
  de faire bénéficier B de l'expérience industrielle d'un producteur mondial de fils et/ou fibres chimiques;
  de développer une industrie française de la construction de matériel pour la fabrication et la transformation de fils et/ou fibres chimiques;"
- "Considérant que X désire participer au développement de cette nouvelle industrie pour mieux mettre en valeur sa main-d'œuvre, ses propres investissements et son know-how en matière de . . . ; qu'elle désire également renforcer sa participation dans cette

industrie au cas où il s'avèrerait, à la suite de l'expérimentation, qu'une telle extension de sa participation serait souhaitable; que cette participation permettrait à X d'utiliser pleinement les actifs dont elle dispose actuellement, étendrait ses activités dans un secteur nouveau de l'industrie du . . . et contribuerait ainsi à préserver sa position dans cette industrie en s'adaptant à son évolution; . . ."

The technique of setting the contract in its context can be used to satisfy a desire to provide an aid to interpretation for use in the event of any future disagreement between the parties.

In the following extract from the recitals to a joint venture agreement, the parties describe the fundamental reasons for their alliance:

"l'organisation de cette entité reposerait sur l'idée fondamentale qu'elle constitue un moyen au service des parties destiné à faciliter la coordination de leurs efforts et de la mise en oeuvre de leurs moyens respectifs et à améliorer les résultats de leur coopération en vue de réaliser les objectifs susvisés."

Descriptions of the parties' objectives are sometimes given a journalistic ring, as in the recitals to this franchise agreement:

"Les difficultés dont souffre le commerce indépendant en général, y compris celui de la quincaillerie, proviennent d'un certain nombre de causes dont les principales sont les suivantes:

"les consommateurs ont de plus en plus tendance à estimer trop élevé le prix des marchandises qui leur sont offertes;

"l'accroissement continu des charges d'exploitation rend de plus en plus difficile l'équilibre des entreprises;

"une concurrence croissante disposant d'un pouvoir d'achat important et de puissant moyens d'action, utilisant les techniques les plus modernes de distribution, attire à elle une part croissante du marché au détriment du commerce isolé.

"Afin de reprendre leur place et de retrouver une pleine activité, les commerçants indépendants n'ont d'autre moyen que d'unir leurs efforts en se groupant pour mettre en commun leur capacité d'achat et d'accéder ainsi aux méthodes commerciales modernes qui font le succès de leurs concurrents."

No doubt this is inspired by the desire to *sell* the franchise agreement to the franchisee and perhaps also to provide future justification for the contract under competition law by stressing the aim of rationalization.

In some contracts with developing countries, the recitals serve to set the contract within the regulation of foreign investment[12] and the economic policy objectives pursued by the government of the country in question:

> "que X est chargée, sous sa responsabilité, de promouvoir l'industrialisation (du pays Z) dans le domaine de la construction mécanique;
>
> "que X a plus particulièrement pour mission la création d'une industrie autonome et indépendante susceptible de répondre aux besoins actuels et futurs (du pays Z) en matière de constructions mécaniques et, notamment, dans le domaine de la fabrication et de la distribution de cycles, de cyclomoteurs et de moteurs . . .
>
> "que le Constructeur accepte la mission qui lui est confiée dans le cadre des principes définis par (le pays Z) dans le but de développer son économie nationale."

Some recitals refer to the New International Economic Order[13]

> "attendu que X et Y, conscients de contribuer ainsi à l'édification d'un nouvel ordre économique international, ont décidé de conclure la présente Convention Générale de Coopération, pour établir entre elles une coopération institutionalisée et pour fixer les principes et le cadre de cette coopération."

Below we shall describe the possible consequences that such a reference may have on the parties' obligations under the contract.[14]

3. *The Spirit in Which the Parties Have Entered Into the Contract*

When an agreement raises sensitive issues for its signatories, for example, with regard to their relations with their principals, recitals can serve as an opportunity to state the spirit in which each party is entering into the agreement. Take as an example this extract from an agreement entered into in 1964 in Belgium between the public administration, trade unions

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[12] See, for instance, the recitals of the contract leading to the Pyramids arbitrations (ICSID decision, November 27, 1985, XVI *Yearb. Com. Arb.* 1991, 16).

[13] About the New International Economic Order, see *infra*, p. 93.

[14] See *infra*, p. 93.

and parties from the private sector. The agreement relates to the organization of the production and distribution of gas and electricity:

> "Les organisations signataires, tout en ne se considérant pas comme engagées de façon générale sur le plan des principes applicables en matière économique et sociale, indiquent ci-après dans quel esprit elles signent la Convention:
>
> "Les organisations syndicales des travailleurs et la FIB, considérant, d'une part, les résultats obtenus par la formule de contrôle de l'électricité dérivant de la Convention de 1955 mais, d'autre part, la limitation du champ d'activité de celle-ci aux producteurs-distributeurs privés, se réjouissent de voir aboutir les efforts tendant à incorporer dans la Convention de contrôle l'ensemble du secteur de l'électricité. Par ailleurs, étant donné les activités mixtes (électricité et gaz) exercées par certaines sociétés, et l'aspect d'utilité publique de l'approvisionnement en gaz, elles se réjouissent également de l'adhésion à la Convention de la partie privée de ce secteur et espèrent pouvoir étendre cette adhésion à l'ensemble de celui-ci.
>
> "Ces organisations ont entendu également orienter vers une action de prévision et de programme la mission du Comité de Contrôle et donner à son secrétariat les moyens voulus pour la remplir.
>
> "Les entreprises privées d'électricité, fortes de l'expérience acquise, se rallient à une consolidation de la formule de contrôle. Les entreprises publiques d'électricité et les unions de centrales industrielles, considérant qu'elles ne peuvent rester en dehors d'un mouvement de coordination de la politique de l'électricité, décident d'adhérer à la Convention dans les limites indiquées respectivement dans les statuts de la SGSPE et dans la convention avec le Comité de gestion des entreprises d'électricité.
>
> "Les entreprises privées gazières, enfin, se montrent disposées à s'engager dans un système de contrôle qui a fait ses preuves en électricité.
>
> "De son côté, le Gouvernement, conscient de sa responsabilité en matière de politique énergétique et considérant que la nouvelle convention de l'électricité et du gaz a le mérite d'étendre un système qui, jusqu'à présent, a donné d'heureux résultats, approuve cette convention et y apporte sa collaboration. Il a entendu y définir son rôle et ses prérogatives.

"Toutes les parties constituantes et le Gouvernement se rallient aux objectifs de la Convention, soit, dans l'intérêt général, poursuivre la rationalisation des secteurs et la réalisation d'une gestion plus coordonnée et plus unifiée pour arriver à un abaissement des prix de l'électricité et du gaz, en tenant compte de la situation économique et du caractère de service d'utilité publique des secteurs."

4. Circumstances Preceding and Surrounding the Contract

Recitals are often the place where parties recount the circumstances which have preceded and which surround the entering into the contract.

Here are two examples of this:

- "The Giotto project is undertaken to achieve an exploratory mission to the Comet Halley, Giotto is to be launched by an Ariane lauchner in a tight single launch window in July 1985. The encounter with Halley is to take place in March 1986. The principal objectives of the Giotto experiments include imaging the nucleus of the Comet Halley and chemical analysis of the Coma during a fast fly-by. The Giotto project principally consist of three parts:
  "the Giotto Spacecraft (hereinafter referred to as Giotto) and
  "the Giotto Experiment Payload (hereinafter referred to as the Experiments) and
  "the Giotto ground segment. . . ."
- "Il a été préalablement exposé:
  "1. Qu'après la découverte, au . . . , d'un gisement de calcaire, X a fait procéder à une étude sur la rentabilité de l'investissement nécessaire à la construction et à l'exploitation d'une cimenterie installée à proximité dudit gisement;
  "2. Qu'après examen de cette étude de rentabilité, X a décidé de construire à proximité du gisement découvert une cimenterie de deux lignes de production capable de produire annuellement un million deux cent mille tonnes de clinker, ladite cimenterie devant s'approvisionner aux carrières d'exploitation dudit gisement, la production de clinker devant être en partie utilisée au . . . et en partie exportée, notamment en . . ."

The description of the contractual context can include commercial, political, technical and other elements affecting the contract, as well as the allocation of risks decided by the parties. In the financial sector, the recitals may refer to the transactions that are the subject matter of the operation, such as buyers' credits, which identify and describe in detail the commercial contract that is being financed.[15]

[15] G. Bourdeaux, *Le crédit acheteur international*, Paris, Economica, 1995, pp. 149–150.

Such descriptions of the environment in which the contract has been entered into appear capable of affecting the future interpretation of the contract.[16] Could they not also facilitate the adaptation or the termination of the contract if the circumstances described in the recitals proved different from reality or if they changed drastically?[17]

Describing the circumstances that led to the making of the contract seems particularly important in the case of settlement agreements given that the recitals will outline the dispute that the settlement is intended to bring to an end:

> "en date du 12.12.1977, X a passé commande à Y d'un remorqueur baptisé ultérieurement . . . Dans le cadre de cette commande, Y a passé différents contrats . . . pour la fourniture de deux moteurs de propulsion entraînant chacun une pompe à incendie, sans qu'il soit utile ici d'entrer dans le détail de ces contrats ou des responsabilités en découlant. Postérieurement à la livraison du navire, les groupes propulseurs pompes à incendie furent l'objet de graves détériorations qui nécessitèrent des travaux et dépenses importantes dont le montant s'est élevé à près de 650.000 francs.
>
> "Les parties au présent protocole n'ayant pu se mettre d'accord sur les causes et responsabilités des désordres constatés, une expertise amiable fut confiée à M. W par un accord en date du 25 avril 1983.
>
> "M. W ayant déposé son rapport le 13 janvier 1984, les parties se sont alors rapprochées pour trouver une solution amiable à leur différend.
>
> "C'est dans ces conditions qu'il a été convenu ce qui suit . . ."

The need to describe the circumstances in which the contract has been concluded also appears when the purpose of the contract is to amend a pre-existing contract. Here, the parties feel the need to explain the amendments and to set them in context:

> "whereas, Primo and Secundo have entered into a . . . 'Products Agreement' as of the first day of January 1980 (hereinafter referred to as 'The Agreement');
>
> "whereas, it has now become apparent to Primo and Secundo that Paragraph 4.03 of The Agreement does not adequatly protect Secundo's interest, and

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[16] See *infra*, pp. 88–89.

[17] See *infra*, pp. 92–93.

"whereas, in the furtherance of a good business relationship, Primo desires that Secundo's interests be adequately protected;

"now, therefore, in consideration of the premises and the mutual convenants herein set forth, it is agreed that the first sentence of Paragraph 4.03 of the Agreement shall be amended to read as follows: . . ."

5. Links With Other Contracts

Contracts sometimes have links with other contracts. In such cases, recitals frequently make reference to this fact:

- "whereas Buyer has previously purchased from Seller one Proof-of-Concept Widget under a Purchase Order, dated as amended;
  "whereas Buyer and Seller have previously entered into a Widget Sales agreement (hereinafter 'Sales Agreement'), dated . . . ;
  "whereas Buyer and Seller have previously entered into a License and Technical Assistance Agreement (hereinafter 'LTAA'), dated . . . , concerning the Widget;
  "whereas Buyer and Seller desire to continue their cooperative efforts to develop, manufacture, market, and sell the Widget; . . ."
- "Il a préalablement été exposé que:
  "1) Le 'Ministry of Works' de la République de . . . (ci-après dénommé le 'Client') a conclu avec l'E.G., le . . . mil neuf cent quatre vingt deux, un contrat relatif aux études, génie civil, fournitures, montage et toutes opérations de mise en service d'un complexe . . . à ériger sur le site de . . . que le Sous-Traitant a visité antérieurement aux présentes. Travaux ci-après désignés comme: le 'Main Contract' (ou le 'Contrat Principal') ou 'l'Entreprise.'
  "2) De son côté, à l'issue des négociations de . . . auxquelles . . . a participé activement et après avoir pris connaissance du 'Main Contract,' le Sous-Traitant déclare . . .

The following example is the recitals to a contract entered into by the supplier of an industrial plant who was required to accept part payment in the form of crude oil, with a third party agreeing to repurchase the crude oil against payment of a commission:[18]

"Engineering C négocie avec la State Chemical Company (S.C.C.) un contrat industriel pour la fourniture d'unités de traitement faisant partie du projet d'aromatiques d' . . .

[18] For a more detailed account of such a scenario see M. Fontaine, Aspects juridiques des contrats de compensation, *D.P.C.I.*, 1981, pp. 203–213.

> "Dans le cadre de ce projet, Engineering C ou l'acheteur qu'il aura désigné sera amené à garantir à la State Petroleum Company (SPC) le débouché aux prix et conditions officielles de la SPC de 4 000 000 Tonnes de Brut dont 70% sous forme de grade lourd 31–31.09 API et 30% sous forme de grade 1 Léger 34–34.09 API."

References to linked contracts undoubtedly shed light on the significance of the contract in which they are contained. Sometimes it may be arguable that such references bring about some degree of legal linkage between the various contracts.[19]

Linkage of this sort is undeniable in the following extract, also taken from a sub-contract:

> "In view of this, A shall design, manufacture, deliver CIF, guarantee and generally assure the obligations described in the Main Contract Documents on his equipment in the same manner as a direct Contractor towards Electric Company, as well as assure the erection, supervision and commissioning test on site, if required. A will be bound by all and any decision taken by E.C. and in particular: modifications, suspension or termination of the Main Contract. . . ."

The following example relates to a transfer of shares and makes the performance of a concurrent contract a condition precedent to the entry into force of the contract which contains these recitals:

> "Considérant qu'un Accord d'Achat (ci-après dénommé 'Accord d'Achat') daté du 30 juillet 1970 est souscrit simultanément avec le présent par et entre A, C et B pour formuler les modalités suivant lesquelles A devra acheter, ou avoir acheté à la Date de Clôture (ci-après dénommée "Clôture") tels qu'ils sont définis dans ledit Accord d'Achat, les actions, prêts et avances ci-dessus mentionnés,
>
> "Considérant que les parties signataires souhaitent exposer dans le présent accord général leur accord en ce qui concerne les intérêts respectifs qu'elles vont avoir dans le capital de X et dans les prêts et avances à elles consentis, ainsi que les prix à payer par chacune d'elles pour ce faire, en ce qui concerne la manière dont X sera organisée, contrôlée, dirigée et gérée, d'un commun accord entre elles, aussi bien qu'en ce qui concerne les autres sujets dont question ci-dessous, dans le cas où les transactions prévues dans l'Accord d'Achat sont effectivement réalisées à la Clôture . . ."

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[19] See *infra*, pp. 95–96.

6. Stages of the Negotiations Leading Up to the Contract

Often, recitals serve as an opportunity to set out a chronological account of the different stages of negotiations which have led to the making of the contract. Here is an example of this:

1. "Attendu que l'Agence a envoyé le 05 Octobre 1982 au Contractant une demande de révision de son offre de Novembre 1979 pour la réalisation d'une série de satellites Meteosat pour un système météorologique opérationnel (Réf.: Demande d'offre n° RFQ/3-3425/82/F, sous couvert de la lettre n° ON/2703-82/CG/fd datée du 5 Octobre 1982)."
2. "Attendu que le Contractant a répondu à cette demande d'offre révisée, par sa proposition de Novembre 1982 et par les amendements qui y ont été apportés jusqu'en 1983."
3. "Attendu que l'Agence a établi et signé le 24 juin 1983 une lettre (Réf.: ON/2794-83/CG:fd) de notification de son intention de conclure un contrat pour les travaux précités (3 satellites plus un jeu pré-assemblé d'éléments de rechange) et d'autorisation formelle d'entreprendre immédiatement les travaux."
4. "Attendu que le Contractant a formellement accepté tous les termes de cette lettre, en apposant sa contresignature le 18 juillet 1983."
5. "Attendu qu'une seconde lettre (Réf.: ON/2844-83/CG/fd datée du 27 Décembre 1983) a été signée par les deux Parties, les 5 et 11 Janvier 1984, pour prolonger jusqu'au 1er Avril 1984 l'autorisation formelle d'entreprendre les travaux et pour établir ou amender certains termes du contrat en préparation."
6. "Attendu que ces lettres ont prévu la conclusion d'un contrat dans un délai spécifié, l'entrée en vigueur de ce contrat avec effet rétroactif au 21 Juin 1983, et l'annulation consécutive du caractère contractuel des dites lettres."
7. "Attendu que les deux Parties ont achevé la négociation des termes et conditions nécessaires à l'établissement d'un contrat complet."
8. "Le lien contractuel entre l'Agence et le Contractant est à présent établi et défini par le présent contrat que les Parties substituent aux lettres précitées."

A factual account such as the above can obviously have a different ending, such as in the following example:

> "en ce qui concerne toute matière qui ne serait pas spécifiquement traitée dans le présent contrat, les deux Parties conviennent de se référer en priorité aux autorisations préliminaires d'entreprendre les travaux (en cas de conflit, la plus récente devant prévaloir), et aux lettres de l'Organisation confirmant au Contractant les accords conclus sur les prix négociés et définitivement approuvés; en cas de lacune, les deux Parties conviennent de se référer sub-

sidiairement aux termes de l'Appel d'Offres n° . . . révisé en juillet 1973, émanant de l'Organisation, ainsi que de la proposition soumise par le Contractant le 16 août 1973 et révisée par celui-ci le 1er octobre 1973 ainsi qu'à l'occasion de la revue critique de conception tenue du 27 au 31 mai 1974 (les termes de l'Appel d'Offres devant prévaloir sur ceux des documents émanant du Contractant, et en cas de conflit entre les documents précités émanant du Contractant, le document le plus récent faisant foi)."

Such an account of the different stages of contract negotiations can, at the very least, have an effect on how pre-contractual documents can be used to interpret the contract.[20]

7. *Acknowledgements and Statements by the Parties*

Immediately prior to the making of a contract, it is not infrequent for one of the parties to require the other party to acknowledge certain facts that may have some bearing on how the contract is to be performed. This is done to ensure that such facts were fully acknowledged at the time the contract was entered into and thus to avoid any subsequent dispute in relation to them.

- "Whereas previously to the execution of the . . . , Contractor has satisfied himself as to the nature of the site of the Works, and the physical conditions there prevailing, in so far as they affect the Works or the execution thereof and has also satisfied himself as to where and in what manner the labour, materials, and equipment required for the Works can be obtained and has made every allowance he considers desirable in his own judgement in view of his own information, for all and such matters in the Scheduled Rates and Prices."
- "Afin de permettre à B de contracter en connaissance de cause, A a communiqué à cette dernière la totalité des documents en sa possession relatifs aux Brevets Licenciés et en particulier le résultat des recherches d'antériorité."

Particularly noteworthy is the reference in the following example to the existence of pending litigation:

"Whereas, Primo has agreed to grant to Tertio and Tertio has agreed to accept from Primo, although aware of the pendency of litigation concerning the validity and enforceability of the aforesaid patent, a non-exclusive license under United States patent No. . . . , all on the terms and conditions hereinafter set forth."

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[20] See *infra*, pp. 88–90.

In other instances, one or both of the parties acknowledge circumstances which will affect the performance of the contract:

- "X has represented that he is presently qualified to act in the abovementioned capacities in the Kingdom of Saudi Arabia and that he will forthwith satisfy all requirements (including as to nationality) to remain so qualified for indefinite future."
- "Whereas, A has the financial ability, technical competence and professional skills necessary to carry out the Petroleum Operations Hereinafter described, . . ."
- "Considérant que ni A ni le franchisé n'ont, à ce jour, signé un quelconque accord qui serait incompatible avec le présent contrat, . . ."

Often, recitals contain statements with reference to intellectual property rights:

- "Whereas, R is the owner of patents and patent applications, and may be the owner of further patents and patent applications, in the United States and Canada relating to the manufacture and use of Products (as hereinafter defined) and other spunbonded fabrics; and . . ."
- "1. K has acquired a license under the French Patent Application PV No. . . . registered on . . . in the joint names of Centre National de la Recherche Scientifique and Centre National de Transfusion Sanguine (hereinafter referred to as C.N.R.S. and C.N.T.S.), entitled . . . and its additional Application PV No. . . . registered on . . . , in the joint names of C.N.R.S. and C.N.T.S.
- "2. Said license is an exclusive manufacturing license for the whole world, an exclusive sales license for the whole world and a license permitting sub-licensing for the manufacture and sale in the whole world, of equipment conceived under the patent and the additionnal Application mentioned hereinabove in the first Whereas.
- "3. Applications corresponding to the above have also been filed in the United States of America, on . . . and in Canada, on . . . under Ser. No. . . . and . . . respectively."

In all of these different examples, it seems that the underlying objective is either to avoid any subsequent dispute based on alleged ignorance of the circumstances described in the recitals or to provide a basis for litigation or enforcement in the event that one of the acknowledgements proves to be inaccurate or is not adhered to.[21]

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[21] See *infra*, pp. 91–92.

8. Statement of Parties' Undertakings

Although the recitals precede the body of the contract, they sometimes contain the apparent statement of genuine obligations.

Such is the case in this agreement to accept joint and several liability:

"Whereas A now wishes to assign the Lease to B, which wishes to take it over, and A agrees that it will be jointly and severally liable for the obligations undertaken by B pursuant to this Assignment."

In this undertaking to procure performance by third party entities:

"Whereas, the parties hereto propose that, pursuant to the terms and conditions hereinafter set forth, A shall cause W Subsidiary, a corporation to be incorporated under the laws of the State of Delaware, a wholly-owned subsidiary of A, and B shall cause X Subsidiary, a corporation to be incorporated under the laws of the State of New York, a wholly owned subsidiary of B, to establish a partnership (the "Partnership") under the laws of the State of . . . in which each W and X will have a fifty percent (50%) interest."

In this agreement to indemnify:

"Whereas, A has agreed, in order to induce the Bank and W to assume the obligations as aforesaid: (i) to indemnify the Bank (for the account of the Bank, and W as their respective interests may appear) against any and all losses arising from the difference between the amount of funds expected to be forthcoming from the Ultimate Borrower and the aggregate amount of funds required to service the Fiduciary Credit, the Swiss Franc Credit and the Supplementary Credit, and to pay the Bank certain other amounts in connection with arranging the financing . . ."

In this provision concerning prices:

"Seller and Buyer desire to enter into a long-term Contract, whereby Seller will sell and Buyer will buy the naptha at prices conditions applicable from time to time to similar term contracts for similar quantities in Northwest Europe."

In this hardship clause:

"(Les sociétés soussignées) reconnaissent que l'esprit qui régit le présent contrat et qui a conditionné leur adhésion à celui-ci est un esprit de solidarité, suivant lequel chacune d'elles doit tenir

compte des situations propres des autres co-signataires. Notamment si l'application du présent contrat infligeait à l'une d'elles un préjudice anormalement élevé par rapport à celui supposé par l'ensemble d'entre elles, les sociétés soussignées acceptent que les effets en soient équitablement répartis. . . ."

In this warranty as to the quality of work to be carried out:

"A garantit une construction soignée effectuée suivant les règles de l'art, concernant la manipulation d'un gaz corrosif et la pratique des installations frigorifiques au fréon et à l'ammoniac.

"A garantit aussi que l'étui et l'installation s'effectueront selon les normes bien connues d'elle par son expérience pratique."

And in this definition of territory:

"Whereas, Licensee is desirous of manufacturing the Products within the following manufacturing area (hereinafter called the Manufacturing Area), namely, that part of the United Kingdom of Great Britain and Northern Ireland (United Kingdom) included within England and the metropolitan territories of Belgium, France, Federal Republic of Germany (West Germany), Italy, Luxembourg and Netherlands, the Product to be so manufactured for sale and use within the following sales area (hereinafter called the Sales Area), namely, the British Isles, composed of the territory of the Republic of Ireland and those parts of the United Kingdom included within Wales, Scotland, England and Northern Ireland; the territory of Iran; continental Europe, composed of . . . (etc . . .)."

Sometimes the recitals even describe the parties' primary obligations under the contract:

- "Whereas the Contractor admits that unless the execution of the Works is seriously hindered or delayed by unforeseen difficulties he can by skill and diligence complete and deliver up and accordingly in his Tender has undertaken to complete and deliver up the whole of the said Works on or before the . . . day of . . . One Thousand Nine Hundred and . . ."
- "In consideration of the mutual covenant herein contained, the Builder agrees to build, launch and complete One(1) Oil Tanker, more fully described in Article 1 hereof, to be registered under the flag of Liberia at the Shipyard in Japan, owned by the Builder or designated by the Builder at its sole discretion (hereinafter called Shipyard) and to deliver and sell to the Buyer, and the Buyer

agrees to purchase from the Builder and to accept delivery from the Builder the said Vessel, all upon the terms and conditions hereinafter set forth."

- "La convention dont le descriptif suit, a pour objet sur le plan local:
  "1) La concession par le concédant au concessionnaire d'une manière indissociable:
    — de l'exclusivité d'exploitation de sa marque et de l'utilisation de son enseigne,
    — de l'exclusivité de la fourniture en gros pour la revente au détail des marchandises portant l'étiquette . . . et éventuellement la marque, fournies en exécution du présent contrat, sous réserve de ce qui est ci-après en ce qui concerne les ventes directes.

  "En conséquence, le concédant s'interdit, dans le territoire concédé, d'exploiter directement ou indirectement une chaîne de distribution spécialisée dans la vente d'articles concurrents, à l'exception de la chaîne . . .

  "2) L'engagement du concessionnaire envers le concédant:
    — d'exploiter au mieux la marque et de maintenir le bon renom de l'enseigne concédée, par le meilleur service au consommateur,

  "de s'approvisionner exclusivement, sous réserve de ce qui est dit à l'art.7 § 4 b pour les articles sus-indiqués, auprès du concédant et des fournisseurs agréés par celui-ci, et de toute façon d'acheter par campagne de vente (6 mois) un montant minimum garanti de marchandises au concédant."

The different examples set out above raise some perplexing questions. If the recitals are to contain provisions that create true substantive obligations, where is the dividing line between the recitals and the body of the contract? Should statements contained in the recitals be endowed with the same legal significance as those contained in the body of the contract?[22]

9. *Definition of Terms*

A widely adopted practice is to define certain terms used in the contract. Sometimes, these definitions are put in the recitals. One example of this was already mentioned above in the case of the recitals which define certain territories. Here is another example:

> "For purpose of this Agreement, the following terms shall have the meaning designated in this Section, unless the context otherwise requires:

[22] See *infra*, pp. 96–98.

"Affiliate is any other person, who is directly or indirectly controlling it, controlled by it or under common control with that Affiliate.

"RC Know-how means . . . (etc . . .)"

Agreement on defined terms certainly appears to constitute agreement on a substantive matter in the same way as the examples set out in Section II.D.8 above amount to agreements on substantive matters.

III. RATIONALE FOR RECITALS

What is the rationale for including recitals at the beginning of a contract?

It is difficult to provide a response to this question. Sometimes, it seems that inclusion of recitals results not from any particular reason but simply from the desire to conform to established practice, without there being any ulterior motive.

More often, recitals are, however, drafted with the greatest of care and their contents reflect pre-occupations of one or both of the parties to the contract. There are even instances in which the contents and the drafting of recitals are the subject of heated negotiations that are almost more difficult than those which relate to the body of the contract. This can be the case when some of the statements contained in the recitals result from one or more of the factors described above.

In the second part of this chapter we shall deal with the extent to which the specific objectives resulting from these factors are likely to be achieved.

Occasionally it appears that inclusion of recitals is driven by entirely different objectives, having nothing to do with the way in which the contract is to be performed. Some contract draftsmen include recitals in order to provide information to the management of their companies; reference to properly worded recitals allows readers who may have little time to read the contract in detail and who may not be lawyers to set the contract in its context and to understand its essential features (some sort of an executive summary). This may be a practical approach but it is not always without the danger of adulterating the contract with an over-simplified summary that may contain imprecisions or even statements that contradict those made in the body of the contract.

In other instances, certain passages contained in the recitals are intended to be read by third parties, for example the tax authorities, authorities that have to authorize the making of the contract, competition law enforcement authorities, even trade unions, the hope being that such

passages will produce a favorable reaction. We already gave an example of recitals in which the objective of certain parts seems to be to support arguments in favor of compliance with the rules of competition.[23]

Here is another example which has the clear aim of arousing the sympathy of the authorities of a developing country which would have to authorize the contract.

> "Considérant l'urgence de créer une infrastructure agro-industrielle, nécessaire à la réalisation des plans successifs de développement élaborés par le Gouvernement du . . . , la Société . . . a élaboré un projet prévoyant la création d'une Société de droit . . . ayant pour objet la construction, l'installation et l'exploitation d'une ferme d'embouche, sise dans la région de . . . ;
>
> "Le montant de l'investissement prévu s'élève à . . . L'exploitation de la ferme entraînera la création d'environ 15 emplois (quinze) d'expatriés et d'environ 680 emplois de (nationaux);
>
> "Compte tenu de l'importance des capitaux investis;
>
> "Eu égard à l'ampleur des effets directs et indirects de l'investissement prévu sur l'activité économique;
>
> "Compte tenu de la concordance du projet avec les objectifs du Gouvernement de la République du . . ."

Recitals are used in pursuit of a variety of objectives. Such diversity is bound to affect the legal implications.

IV. LEGAL IMPLICATIONS

A. Recitals and Similar Phenomena

Contracts are not the only type of legal documents that contain recitals. Often, the author(s) of written texts spontaneously feel the need to give some explanation or justification. In the case of legal documents, setting out reasons is often mandatory in order to safeguard the rights of the person to whom the decision applies.

1. International Treaties

International treatises often begin with recitals.[24] Here is an extract from the recitals to the Treaty dated January 27, 1967 on the Exploration of Outer Space:

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[23] See *supra*, pp. 65–67.

[24] P. You, *Le préambule des traités internationaux*, Fribourg, Librairie de l'Université, 1941, 146 pp.; J. Corriente Cordoba, *Valoracion juridica de los preambulos de los tratados inter-*

"The States Parties to this Treaty,

"Inspired by the great prospects opening up before mankind as a result of man's entry into outer space,

"Recognizing the common interest of all mankind in the progress of the exploration and use of outer space for a peaceful purposes,

"Believing that the exploration and use of outer space should be carried on for the benefit of all peoples irrespective of the degree of their economic or scientific development,

"Desiring to contribute to broad international co-operation in the scientific as well as the legal aspects of exploration and use of outer space for peaceful purposes,

"Believing that such co-operation will contribute to the development of mutual understanding and to the strengthening of friendly relations between States and Peoples,

"Recalling resolution 1962 (XVIII), entitled 'Declaration of Legal Principles Governing the Activites of States in the Exploration and use of Outer Space,' which was adopted unanimously by the United Nations General Assembly on 13 December 1963, . . .

". . . Have agreed on the following: . . ."

Article 31(2) of the Vienna Convention dated May 23, May 1969 on the Law of Treaties expressly recognizes the value of recitals as an aid to treaty interpretation.

2. European Union Acts

Article 253 of the EU Treaty provides that regulations, directives and decisions of the Parliament and the Council, of the Council or of the Commission are motivated and must refer to the proposals or to the opinions that had to be obtained pursuant to the Treaty.

An application of this can be seen in the Directive dated March 5, 1979 on life insurance:

"The Council of the European Communities,

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nacionales, Pamplona, Editiones Universidad de Navarra, 1973, 68 pp.; A. Salomon, *Le préambule de la Charte, base idéologique de l'ONU*, Geneva, Editions des trois collines, 1946, 229 pp.

"Having regard to the Treaty establishing the European Economic Community, and in particular Articles 49 and 57 thereof,

"Having regard to the proposal from the Commission (OJ No. 6 35, 28.3.1974, p. 9).

"Having regard to the opinion of the European Parliament (OJ No. C 140, 13.11.1974, p. 44),

"Having regard to the opinion of the Economic and Social Committee (OJ No. C 109, 19.9.1974, p. 1),

"Whereas, in order to facilitate the taking up and pursuit of the business of life assurance, it is essential to eliminate certain divergences which exist between national supervisory legislation; whereas, in order to achieve this objective and at the same time ensure adequate protection for policy-holders and beneficiaries in all Member States, the Provisions relating to the financial guarantees required of life assurance undertakings should be coordinated;

"Whereas . . ."

There then follows a long series of recitals setting out the reasons for each of the operative provisions of the Directive and ending:

"whereas it is important to guarantee the uniform application of the coordinated rules and to provide accordingly for close collaboration between the Commission and the Member States in this field,

"Has Adopted This Directive

"Title I . . ."

Particularly noteworthy is the requirement in Article 253 for reference to proposals and opinions required under the EU Treaty.

The Court of Justice has held that the obligation to set out reasons "is intended to allow parties to defend their rights, to allow the Court of Justice to exercise its supervisory jurisdiction and to allow the Member States and any citizen thereof who has a legitimate interest to understand the way in which the Commission has applied the EC Treaty."[25] Academic writers have asserted that setting out reasons also provides a means of information to the European Parliament, aids interpretation of the decision and

[25] Judgment of July 4, 1963, *ECR*, 1963, p. 143.

is conducive to efficient functioning of authorities who have to look into the reasons why the decision was reached.[26]

Although the Court of Justice requires less detailed reasoning of legislative texts then of decisions,[27] one Regulation has nonetheless been annulled for failure to set out sufficient reasons.[28]

3. Constitutions

The Constitutions of certain countries begin with recitals. The recitals to the Constitution of the United States of America set out as a Preamble are particularly well known:

> "We the People of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquility, provide for the common defence, promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States of America."

The contents of recitals to Constitutions vary considerably. Sometimes, as in the above example, the recitals solemnly declare the promulgation of the Constitution that follows them (also the case in the recitals to the Swiss Constitution of 1874[29] and the Constitution of the Republic of Ireland of 1937). Sometimes the recitals set out certain *caveats* that would be inappropriate in the operative part of the constitution (for example the recitals to the Constitution of the Federal Republic of Germany of 1949, which contained the *caveat* that the Constitution was to be temporary since it had not been assented to by the entire German nation). In other cases, recitals to Constitutions contain solemn declarations of adherence to certain principles and to citizens' fundamental freedoms (for example the French Constitutions of 1946 and 1958).[30]

The legal significance of recitals to Constitutions has given rise to debate. That legal significance varies from case to case. It may be that while appearing to endow principles stated in the recitals with added solemnity, the draftsmen of the Constitution avoid the risk of parties relying on such

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[26] J. Megret et al., *Le droit de la Communauté économique européenne*, Brussels, ULB, vol. X, 1993, p. 524.

[27] *Id.*, pp. 505–506.

[28] Judgment of July 7, 1981, *ECR*, 1981, pp. 1833–1934.

[29] V.L. Waser-Huber, *Die Präambeln in den schweizerischen Verfassungen*, Bern, Peter Lang, 1988, 217 pp.

[30] P. Biscaretti di Ruffia & S. Roszmaryn, *La Constitution comme loi fondamentale dans les Etats de l'Europe occidentale et dans les Etats socialistes*, Paris, L.G.D.J., 1966, pp. 42–43.

principles as a basis for judicial review proceedings.[31] On the other hand, a tendency has been noted towards a stronger normative character to constitutional preambles, e.g., in France and in Germany.[32]

4. Statutes and Regulations

Legislation and instruments having regulatory character sometimes begin with introductions comparable to recitals. Such introductions do not constitute preparatory documents (which consist of documents issued before the preparation of the draft instrument, the draft instrument itself, the statement of reasons for its enactment, parliamentary reports and accounts of parliamentary discussions, etc.), which are analogous to precontractual negotiations and the different documents exchanged in the course thereof (for example letters of intent).[33] Rather, they amount to introductory remarks put into the final version of the legislative or regulatory instrument.

By way of an example, take the commencement of the Belgian Royal Decree of July 17, 1985, which amended the official interest rate:[34]

> "Baudoin, Roi des Belges,
>
> "A tous, présents et à venir, Salut.
>
> "Vu la loi du 5 mai 1865 relative au prêt à intérêt, notamment l'article 2, modifié par l'arrêté royal No. 147 du 18 mars 1935, confirmé par la loi du 4 mai 1936, et modifié par la loi du 30 juin 1970 et par les arrêtés royaux des 14 octobre 1974 et 28 juillet 1981;
>
> "Vu les lois sur le Conseil d'Etat, coordonnées le 12 janvier 1973, notamment l'article 3, §1er, modifié par la loi du 9 août 1980;
>
> "Vu l'urgence;
>
> "Considérant qu'il existe actuellement un écart important entre les taux d'intérêt pratiqués dans les conventions courantes et le taux de l'intérêt légal;

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[31] *Id.*, p. 43.

[32] C. Grewe & H. Luiz Fabri, *Droits constitutionnels européens*, Paris, PUF, 1995, pp. 42–43.

[33] Cf. Chapter 1 *supra*. Likewise, no parallel can be drawn either with explanatory documents that are sometimes issued following the adoption of legislative or regulatory instruments, for example administrative circulars.

[34] *Moniteur belge*, July 23, 1985.

> "Considérant, dès lors, qu'une adaptation du taux d'intérêt légal s'impose au plus tôt afin de réduire l'écart entre ce dernier taux et ceux pratiqués sur le marché des capitaux;
>
> "Sur la proposition de Notre Ministre de la Justice et de Notre Ministre des Finances et de l'avis de Nos Ministres qui en ont délibéré en Conseil,
>
> "Nous avons arrêté et arrêtons: . . ."

Some of the these passages are of use in assessing the lawfulness of the decree: the reference to the laws that are being implemented by the decree (under Article 159 of the Belgian Constitution, challenges to the lawfulness of a decree can be made before Belgian courts) and reliance on the urgent need for the decree to justify failure to request the opinion of the Belgian Conseil d'Etat.[35] The passages beginning with the word *Considérant* have not been drafted to comply with any legal requirement but simply to accord with established practice. However, they may have considerable importance in interpreting the decree.

5. *Judgments and Awards*

There is a further similarity between recitals to a contract and the statement of reasons contained in court judgments. The decision contained in the operative part of the judgment is preceded by a statement of the reasons upon which it is based. For example, judgments written in the traditional French judicial style consist of a series of paragraphs beginning with the word *attendu* or *considérant* leading to the words *par ces motifs* preceding the operative part of the judgment.

What is to be found in the statement of reasons? Statements concerning the attributes of the parties, a description of the dispute, the arguments put forward by each of the parties, some discussion relating to and the reasons why the court has come to its decision. All of these are, *mutatis mutandis,* similar to the contents of recitals to contracts.

In many countries, setting out the reasons on which a judgment is based is a legal requirement, stemming from the Constitution of the country in question (for example Article 149 of the Belgian Constitution). Litigants clearly need to know the reasons for a judgment that will be binding upon them. This is a feature of the smooth administration of justice and a protection against judicial arbitrariness. Absence of or defects in the

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[35] In Belgium, the Conseil d'Etat comprises a legislative section, whose mission is to give prior opinion on legislative and regulatory drafts (laws coordinated on January 12, 1973, Art. 2-6bis).

reasoning leading up to a judgment can provide a basis for appeal. The requirement to state reasons for a judgment obliges judges to specify their views before deciding. By analyzing the reasons upon which judgments are based, lawyers can identify attitudes of the courts to various issues and trends in case law.[36]

Some parts of the statement of reasons can have an even more specific significance. It may be the case that the judge fails to properly distinguish between those issues that should be dealt with in the statement of reasons and those that should be dealt with in the operative part of the judgment, and thus determines a substantive issue in the statement of reasons rather than in the operative part. In such cases, the form of the judgment is considered to be of little importance, and determinations made in the context of the statement of reasons will nonetheless be regarded as *res judicata*.[37]

Under many jurisdictions and also as a result of several international conventions or rules of arbitration, arbitral awards must also state the reasons on which they are based.[38] The reasons for this requirement are similar to those in relation to court judgments. In addition, a statement of reasons can be informative for the courts if proceedings are instituted challenging the award or its enforcement.[39] Including a statement of reasons in arbitral awards is also of particular value to efforts to reconstitute a new *lex mercatoria*.[40]

Irrespective of whether an instrument is a piece of legislation or a judgment, the operative part is often preceded, in the instrument itself, by an explanation (short or long) that is not always devoid of legal significance. The explanation may consist of cross-references to other instruments, allowing the reader to verify the lawfulness of the instrument; it may consist of a series of reasons capable of serving as the basis for proceedings challenging the validity of the instrument if it is legally defective; it may

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[36] Dalloz, *Nouv. Rép. de Droit*, 2nd ed., 1963, Vol. *jugement*, No. 65.

[37] *Id.*, No. 64; J. Van Compernolle, Considérations sur la nature et l'étendue de l'autorité de la chose jugée en matière civile, note under Cass. b., Sept. 10, 1981, *Rev. Crit. Jur. B.*, 1984, pp. 260–264.

[38] R. David, *L'arbitrage dans le commerce international*, Paris, Economica, 1982, pp. 442-456. The dominant tradition was different in English-speaking countries, but even there the trend has developed towards increasingly stating the reasons for arbitral awards (see P. Sanders, *Quo vadis arbitration?*, The Hague, Kluwer Law International, 1999, pp. 31–33).

[39] M. Huys & G. Keutgen, *L'arbitrage en droit belge et international*, Bruxelles, Bruylant, 1981, p. 306; P. Sanders, *op. cit.*, 33.

[40] R. David, *op. cit.*, pp. 455–456; K.P. Berger, The international arbitrators' application of precedents, *J. Int. Arb.*, 1992, pp. 1–22; R.A. Schütze, The precedential effects of arbitration decisions, *J. Int. Arb.*, 1994, pp. 69–75.

consist of a statement of principles or objectives that can be used to aid the interpretation of the instrument.

Analyzing the different effects of recitals on legislative instruments and court judgments prompts one to carefully consider the possible legal significance of recitals preceding contracts, and perhaps, to extrapolate from certain apparent analogies. It should be remembered, however, that unlike legislative instruments and court judgments, contracts are agreements between parties, and not unilateral decisions taken by public authorities. This suggests the need for caution in placing too much emphasis on the similarities between the two.

B. Legal Effects of Recitals to Contracts

What legal significance should be given to recitals? Do the contents of this part of the contract, distinguishable from the body of the contract because of the form they take,[41] have any legal effect ?

In view of the subject matter of most recitals, this may be open to doubt. If the parties feel the need to include recitals, separate from the operative part of the contract, it is because they wish to deal with matters that have no place in the body of the contract. After all, recitals do not generally set out contractual rights or obligations. *Prima facie*, describing the parties' objectives in entering into the contract or the circumstances leading up to and surrounding the contract or even setting out the pre-contractual negotiations, do not seem to create any legal rights or obligations.

However, some recitals contain provisions that may create contractual obligations.[42] In addition, a more thorough examination of recitals suggests that even those that are more literary in style can produce a variety of different legal effects.

Thus, recitals may or may not create legal effects. In practice, recitals often contain elements of both kinds.[43]

The account, which follows, sets out the Working Group's conclusions on the legal effects of recitals. Given that their legal effects have been given little attention in most legal systems, the Group's conclusions cannot, for the most part, be based on case law or on the theories of academic writers.

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[41] Cf. *supra*, p. 62. The formal distinction between recitals and the "*operative part*" of the contract, as well as its practical importance, are also stressed by M. Anderson, *Drafting and negotiating commercial contracts*, London, Butterworths, 1997, p. 28.

[42] Cf. *supra*, pp. 76–78.

[43] Cf. F.W. Grosheide, *op. cit.*, p. 317.

For this reason, they are put forward somewhat tentatively. English law is to be distinguished from other legal systems since certain aspects of the legal effects flowing from recitals have been dealt with in English case law going back as far as . . . the 15th century.[44]

What, then, are the legal effects that may flow from recitals?

- Recitals may serve as an aid to the interpretation of a contract.
- Statements contained in recitals can shore up a claim for avoidance due to defective consent (*vice du consentement*) or misrepresentation.
- Sometimes, factual circumstances described in recitals can amount to the "bases upon which the contract has been entered into" (*Geschäftsgrundlage* or *presupposizioni*), changes that can, in various legal systems, create a right to amend the contract.
- Acknowledgements given by a party in the recitals can be used as grounds to estop that party from subsequently adopting a course of conduct that is inconsistent with those acknowledgements.
- Descriptions of the parties' particular attributes and skills can influence the interpretation of their respective obligations and the extent to which they incur any liability for breach of the contract.
- Recitals, which give an account of the pre-contractual negotiations, can be used to determine the legal status of pre-contractual documents.
- References to other connected contracts or to third parties can create legal linkage between those other contracts or those third parties and the contract that contains the recitals.
- Recitals may already contain substantive contractual provisions.
- It may even be arguable that some statements contained in recitals can serve to demonstrate that the transaction is simulated or provide the basis for claims by third parties.

1. *Interpretation of the Contract*

A principle common to many legal systems is that a contract should be interpreted in accordance with the intentions of the parties to it. Clear illustrations of this principle can be found in Article 1156 of the French Civil Code and in Article 1362 of the Italian Civil Code.[45]

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[44] *Skinner v. Gray* (1595), note to *Mount v. Hodgkin* (1554), 2 Dyer 116a, quoted by *Halsbury's Laws of England*, London, Butterworths, 1975, vol. 12, *Deeds and other Instruments*, § 1509, note 11.

[45] On the interpretation of contracts in comparative law, cf. *infra*, Chapter 3, pp. 106–114.

Recitals can contain many details that clarify such intentions. This is particularly true where the recitals describe the parties' objectives in entering into the contract (the recitals can then be used in connection with a teleological interpretation of the contract) or the circumstances surrounding the making of the contract. In addition, judges and arbitrators may be assisted in interpreting a contract by statements made in the recitals that convey the context of the economic policy pursued by the government concerned or that make reference to the New International Economic Order.[46]

However, other rules of contract interpretation give precedence to the intentions of the parties as they are actually expressed in the contract rather than inquiring as to what the parties' true intentions might have been. Principally for reasons of legal certainty, precedence is give to what a reasonable man would regard as the objective meaning of the words used in the contract. If the meaning of the words is clear, no different meaning, which the draftsman may have had in mind when he drafted the contract, will be sought.[47]

Although theoretical discussions about these two approaches to contract interpretation have aroused less interest in England than in continental Europe, the rules of English law give precedence to the will of the parties as expressed in the contract.[48] As a result, use of recitals to determine the meaning of provisions contained in the operative part of the contract is not permitted if the provisions in question are clear in meaning (whereas Article 1156 of the Napoleonic Code could allow such use).[49] But recitals may be referred to if a provision contained in the operative part is ambiguous. English law contains an important body of case law on the role that recitals may or may not have in the interpretation of contracts.[50]

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[46] Cf. *supra*, p. 67.

[47] Cf. *infra*, Chapter 3, pp. 110–111; C. Del Marmol & L. Matray, L'importance et l'interprétation du contrat (dans ses relations avec l'arbitrage commercial international), *Rev. Dr. Int. Dr. Comp.*, 1980, pp. 158–208.

Both approaches were defended when drafting the German BGB (compare §§ 133 and 157) but precedence is given to the expressed rather than real intention of the parties (K. Zweigert & H. Kötz, *An introduction to comparative law*, 3rd ed., Oxford, Clarendon Press, 1998, pp. 403–406); also see A. Rieg, *Le rôle de la volonté dans l'acte juridique en droit civil français et allemand*, Paris, L.G.D.J., 1961, pp. 358–420.

[48] Cf. *infra*, Chapter 3, pp. 112–113; C. Del Marmol & L. Matray, *op. cit.*, pp. 177–181.

[49] In spite of exceptions, this remains the most important point of difference between the English and continental systems (Cf. F.W. Grosheid, *op. cit.*, p. 319.

[50] Odgers, *op. cit.*, pp. 149–154 and the cases cited; *Halsbury's Law of England*, vol. 12, *op. cit.*, §§ 1509–1511 and the cases cited; K. Lewison, *The interpretation of contracts*, 2nd ed., London, Sweet & Maxwell, 1997, pp. 265–277; A.G.J. Berg, *Drafting commercial agree-*

In view of their fundamental differences of approach to contract interpretation, legal systems do not all attach the same value to the contents of recitals as an interpretative aid. This should be borne in mind. But, it is always a matter of degree and it appears that all legal systems allow recitals to play a greater or lesser role in resolving disputes over how contractual provisions are to be interpreted. This role is recognized in certain practical guides to contract drafting[51] and should be considered together with the interpretative value accorded to the recitals to certain EU legal instruments[52] and to international treaties.[53]

On the other hand, published arbitral awards confirm the interpretative value of recitals, but they also reveal a clear tendency towards a contextual interpretation of the contract, in which the operative part and the recitals help to interpret each other. This approach is explained by the fact that arbitral awards tend to pay scarce attention to the law applicable in matters of interpretation.[54]

The role of recitals as an aid to contract interpretation may become more significant given the current tendency to use word processors to draft contracts that are thus becoming increasingly standardized. Recitals lend themselves less to such a development; instead, they are becoming the place of refuge for items that are specific to a particular contract and which therefore individualize and personalize that contract.

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ments, London, Butterworths, 1991, pp. 53–55; M. Anderson, *op. cit.*, p. 28; M. Anderson, *A-Z guide to boilerplate and commercial clauses*, London, Butterworths, 1998, p. 154.

In case of a clear contradiction between a provision in the recitals and a provision in the body of the contract, one finds opposition between the two approaches to contract interpretation: the theory of declared intention gives priority to the clearly written contractual provision, whereas the theory of real intentions allows use of recitals to prove the intention. The two theories converge in result when the contractual provision is ambiguous.

[51] See *supra*, p.; the UNCITRAL Guide on construction of industrial works confirms that "the extent to which the recitals are used in the interpretation of a contract may vary under different legal systems" (*op. cit.*, p. 49).

[52] Cf. *supra*, pp. 81–83.

[53] Cf. *supra*, pp. 80–81.

[54] ICC Award No. 4132 (1983), *Clunet*, 1983, 891, X *Yearb. Comm. Arb.*, 1985, 49; Ad hoc Arbitral Tribunal (B. Gomard), *Elf Aquitaine Iran v. National Iranian Oil Company*, *Rev. Arb.* 1984, 401, XI *Yearb. Comm. Arb.*, 1986, 97; ICC Award No. 7181 (1992), XXI *Yearb. Comm. Arb.*, 1996, 99; ICSID Award., *SPP (Middle East) Ltd. v. Egypt*, 20 mai 1992, *Rev. Arb.* 1994, 189; ICC Award No. 7639 (1994), XXIII *Yearb. Comm. Arb.*, 1998, 66; ICC Award No. 7314 (1995), XXIII *Yearb. Comm. Arb.*, 1998, 49; ICC Award No. 7337 (1996), XXIV *Yearb. Comm. Arb.*, 1999, 149.

2. Vices de Consentement, *Misrepresentations*

Often, recitals highlight circumstances that have been instrumental in the making of the contract. They may refer to statements of fact (for example the proximity of hydrocarbon or mineral reserves) or representations made by one of the parties (for example, the ownership of a patent).

The various legal systems contain rules that allow a party to challenge contractual obligations that it accepted before it was in full possession of all the relevant facts.

For example, under French Law (Article 1110 of the French Civil Code), a contract can be terminated on the basis of substantive error (*erreur substantielle*) or on the basis of fraud (*dol*) (Article 1116 of the French Civil Code). The applicant has to prove the existence of factors that vitiate its consent (*vices de consentement*), and statements contained in the recitals to the contract can sometimes provide the necessary proof.

Hence, highlighting certain facts in the recitals can contribute greatly to the proof of a mistake (*erreur*), and, particularly, its substantive character.[55] Under French law, error as to a party's reasons for entering into a contract will, in principle, be considered. However, it can be taken into account if these reasons were determining factors in the plaintiff's decision to enter into the contract and if the parties have agreed to bring such reasons within the ambit of the contract. These two conditions might be satisfied if the reasons in question have been highlighted in the recitals to the contract.

Including in the recitals a statement by one of the parties that proves to be false may, in certain circumstances, facilitate proof of fraud. In addition, the absence of certain statements in situations in which they should normally have been made can help prove fraud by silence (*réticence dolosive*),[56] given the current emphasis on the obligation to provide information at the time of entering into a contract.

Alternatively, the inclusion of certain statements in the recitals can subsequently be used to prove that the parties entered into the contract in full knowledge of all relevant facts, thus providing an effective defense to any claim for termination on the basis of error or fraud.

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[55] For a case where this condition was not satisfied, cf. ICC Award No. 6363 (1991), XVII *Yearb. Comm. Arb.*, 1992, 186.

[56] Cf. e.g., J.P. Masson, Les fourberies silencieuses, note under Cass. b., June 8 1978, *Rev. Crit. Jur. B.*, 1979, pp. 527–542.

Under English law, the rules on misrepresentation allow for various remedies for a party who has suffered loss as a result of a false statement made by the other party, with the clear intention of making the injured party enter into the contract (Misrepresentation Act 1967).[57] Recitals often harbor such false statements.

3. *Bases on Which the Contract Was Entered Into*

Following a change in circumstances, to continue to perform a contract, may become difficult for either of the parties. A change in government may modify commercial trends and make certain markets less favorable for exportation. A technological breakthrough may render obsolete the goods being sold under a long-term supply contract. Is it possible to amend the contract so as to adapt it to the changed circumstances or even to terminate it?

This problem arises in all legal systems, but its resolution takes different forms based on a variety of legal concepts (*imprévision, caducité, Wegfall der Geschäftsgrundlage, presupposizioni,* frustration, etc.) that often involve reference to the bases on which the contract was entered into.[58]

In cases where its governing law allows a contract to be challenged by reason of change in circumstances, recitals can play a important role insofar as statements contained in them describe, in detail, the bases for the making of the contract or the environment in which it was concluded. For example, statements in recitals may indicate that parties have entered into a contract because of the existence of an effective distribution network or because of one party's access to preferential terms of supply from one of its affiliates. Should the contractual relationship have to continue if these circumstances no longer pertain?

Using recitals to describe the circumstances prevailing at the beginning of the contract can also help a party if it wishes to avail itself of a hardship clause in the future.[59] Hardship clauses can be made more effective if they contain an express reference to the circumstances described in the recitals to the contract.

Is it possible to go even further and take the view that reference in recitals to the factual context indicates the parties' intention to challenge the contract if those facts no longer pertain, even if the contract contains

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[57] For an account of the rules of English law on misrepresentation see, for example, J. Beatson, *Anson's Law of Contract*, 27th ed., Oxford University Press, 1998, pp. 233–269.

[58] Cf. *infra*, Chapter 9, pp. 453–455.

[59] On hardship clauses, cf. *infra*, Chapter 9.

no hardship clause? This issue turns on the interpretation of the contract, which will itself depend on how the contract's governing law establishes how the occurrence of unforeseen circumstances can affect the contract.

On the other hand, reference in the recitals to the New International Economic Order, an example was cited earlier,[60] can, in itself, suggest a right for one of the parties to precipitate a re-negotiation of the contract in the event of a change in circumstances. Such mitigation of the principle of *pacta sunt servanda* will depend on the content of the New International Economic Order.[61]

4. *Estoppel*

Under English law, a party cannot, in certain circumstances, contradict what it has acknowledged in writing, in a recital for example. In all cases, the acknowledgement in question must be clear, precise and without ambiguity. English case law indicates reluctance to find estoppel on the basis of acknowledgements made in recitals.[62]

5. *Effect on the Parties' Obligations and on the Extent of Their Liability for Breach*

Our description of the contents of recitals has emphasized the frequent insistence on praising a party's particular qualifications and attributes ("among the world leaders in its field").[63] Praise of this kind is not given without ulterior motive. By admitting to be regarded as highly specialized in its particular area, a party agrees, in advance, to the standard by which the performance of its obligations under the contract will be judged. A party that operates at the highest level of its profession should perform its obligations in a manner worthy of its reputation. As such, assessing the

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[60] Cf. *supra*, p. 67.

[61] S.K.B. Asante, Stability of Contractual Relations in the Transnational Investment Process, 28 *Int. Comp. Law Q.* (1979), pp. 401–423; O. Lando, Renegotiation and Revision of International Contracts, *German Yearb. of Int. Law*, 1980, pp. 37–58. It should be remembered that the New International Economic Order is referred to in several instruments adopted by the U.N. on the basis of the Declaration and Action Program of May 1, 1974 (Resol. No. 3201 and 3202). See the comments on the New International Economic Order in L. Matray, Arbitrage et ordre public international, in *The Art of Arbitration* (Liber Amicorum P. Sanders), Deventer, Kluwer 1967, pp. 252–267.

[62] Odgers, *op. cit.*, pp. 154–158 and the references quoted; K. Lewison, *op. cit.*, pp. 275–276. Concerning *estoppel*, cf. E. Gaillard, L'interdiction de se contredire au détriment d'autrui comme principe général du droit du commerce international, *Rev. Arb.*, 1985, pp. 241–258; B. Fauvarque-Cosson, *L'estoppel* du droit anglais, in *L'interdiction de se contredire au détriment d'autrui*, M. Behar-Touchais (ed.), Paris, Economica, 2000, pp. 3–25. Also see the new Article 1.8 of the Unidroit Principles, 2004 edition. On non-waiver clauses, cf. *infra*, Chapter 3, pp. 163–167.

[63] Cf. *supra*, pp. 63–65.

quality of goods that it delivers or services that it provides will be made by reference to the highest standards for such goods or services Emphasizing a party's qualifications or attributes is therefore consistent with high expectations in relation to that party's obligations and liability.

On the other hand, sometimes (as mentioned earlier[64]), a party uses recitals to emphasize its lack of skill in the area in which its counterparty will perform obligations under the contract. In such circumstances, the aim is to reinforce the high standard expected of the latter party because, frequently, a higher standard of performance (obligation to give proper information for example) is to be expected if a person enters into a contract with an another is not engaged in that business.

Some provisions contained in recitals may, in a different way, affect the extent to which a party incurs liability for breach of contract. When the governing law of a contract limits the damages payable following breach to damages payable for foreseeable loss,[65] stating certain facts in the recitals can amount to proof of how foreseeable an alleged loss actually was. No doubt, the famous case of *Hadley v. Baxendale* would have been decided differently if the contract of carriage made between the parties had included a recital explaining the particular importance of the piece of equipment being transported and the fact that it was needed in order to allow the plaintiff's mill to recommence operations.[66]

6. Status of Pre-Contractual Documents

Listing pre-contractual documents in recitals can, subject to other indications, be taken to bear testimony to what the parties regard as the main stages of the pre-contractual negotiations. In the event of a subsequent dispute as to the meaning of certain provisions in the contract, such a list of pre-contractual documents may, governing law permitting, provide clues as to the parties' true intentions.

In some cases, recitals specify the status to be given to pre-contractual documents, either by stating that such documents are to be referred to in

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[64] Cf. *supra*, pp. 63–65.

[65] Such is the case in English law, (M. Elland-Goldsmith, Les principes généraux du droit anglais et les opérations internationales, *D.P.C.I.*, 1980, pp. 465–466), as well as under Article 1151 of the French Civil Code (Ph. Malaurie & L. Aynes, *Cours de droit civil*, Tome VI, *Les obligations*, Paris, 10th ed., 1999, No. 839–842; see also *infra*, pp. 329–393.

[66] 9 Ex. 341, 156 Eng. Rep. 145 (1854). In this case, the owner of the mill did not succeed in obtaining damages from the carrier for loss resulting from the cessation of operations at the mill following delay in performance of the contract of carriage, because the carrier was not aware of the particular importance of the item that it had contracted to transport.

order to fill any gaps in the contract, or, conversely, to state that they are devoid of legal effect and that the contract alone contains all the terms of the agreement between its parties. Some examples appeared above.[67] Provisions of this kind, even if placed in the recitals to a contract, clearly have the effect of operative provisions; they can be and frequently are, set out in the body of the contract.[68]

7. *Links With Other Contracts or With Third Parties*

Reference in a contract's recitals to other contracts with which the contract is in some way connected can result in the creation of a legal nexus between these contracts.[69]

Sometimes, such a nexus is expressly created, as in the case of a sub-contract which refers to the main contract and links certain obligations arising under the sub-contract with those arising under the main contract. In an example given above,[70] the recitals contain a true quoted substantive provision that could, and should preferably, be inserted in the body of the contract.

Other recitals simply refer to other contracts without, in any way, stating what (if any) legal consequences are to result from these references. References of this kind can, at the very least, have some role in the interpretation of the contract in which they are contained,[71] or alternatively, to which they refer. In some instances, the connected contracts are, in economic terms, to be seen as the *raison d'être* of the contract in whose recitals they are referred to. Consequently, such contracts can form part of the *Geschäftsgrundlage* of the contract in question. This may result in the latter contract being affected by matters that relate to the connected contracts (such as their non-existence, voidness, termination, *caducité*, etc.).[72] Issues, such as this, should be clearly dealt with in the body of the contract.

Furthermore, references in a contract's recitals to other contracts can indicate a legal nexus between all of the contracts and justify that different

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67 Cf. *supra*, pp. 73–74.

68 Concerning entire agreement and four corners clauses, cf. *infra*, Chapter 3, pp. 129–150, with an analysis of the problem of conflict between recitals and entire agreement clauses.

69 Cf., in general, *Les effets du contrat à l'égard des tiers, Comparaisons franco-belges*, M. Fontaine & J. Ghestin (ed.), Paris, L.G.D.J., 1992, 464 pp.

70 Cf. *supra*, p. 72.

71 For an example, cf. ICC Award No. 6829 (1992), XIX *Yearb. Comm. Arb.*, 1994, 167.

72 Compare M. Fontaine, Aspects juridiques des contrats de compensation, *D.P.C.I.*, 1981, pp. 211–212 as well as severability clauses, *infra*, Chapter 3, pp. 167–176.

proceedings that, individually, should have been brought before different courts, could be brought together before a single court.

Finally, a more recent development should be pointed out. In two cases, the plaintiff requested arbitration against a third party, which was identified in the recitals of the contract. In the first case, the arbitral tribunal, on the basis of the case file, concluded that the parties had envisaged that the third party was also bound by the contract.[73] In the second case, any such extension was refused.[74] In principle this second approach should be approved. When the operative provisions of the contract are clearly separated from the recitals, a non-signatory is not to be bound by the arbitration clause of the contract. However, these cases establish the risks that are associated with an identification of a third party in the recitals. In practice, this is particularly relevant when dealing with groups of companies and State contracts.

8. Substantive Provisions

Finally, recitals may contain provisions that actually give rise to substantive rights and obligations. Examples of this have just been cited with regard to pre-contractual documents and to links with other contracts. Also cited before were examples of recitals containing provisions establishing joint and several liability, obligations to obtain a third party's undertakings, provisions relating to the calculation of prices or the definition of a contractually allotted territory, hardship clauses and even provisions setting out the parties' fundamental obligations.[75] Attention should also be drawn to the practice of including the parties' identity,[76] a list of contractual documents[77] or definitions in a contract's recitals.[78]

In other instances, recitals can indicate the termination of a prior agreement, contain an agreement to undertake future negotiations or set

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[73] Iran-U.S. Claims Tribunal, *Agrostruct International Inc. V. Iran State Cereals Organization*, Award No. 5, April 15, 1988, XIV *Yearb. Comm. Arb.*, 1989, 354.

[74] See Paris, July 7, 1994, *Rev. Arb.*, 1995, 107.

[75] Cf. *supra*, pp. 76–78. For example, cf. Trib. Gr. Inst. Paris, March 26, 1986, *Rev. Arb.*, 1987, 179, note Ph. Fouchard; an arbitration clause contained in the recitals preceding the operative provisions of a group insurance policy was considered to be enforceable.

[76] Cf. Trib. Première Instance Genève, March 13, 1986, XII *Yearb. Comm. Arb.*, 1987, 514. In this case, the identification of a party and the mention of its location in Swizerland in the recitals were considered to be relevant in respect to a problem of State immunity.

[77] For an example of recitals enumerating the contractual documents and establishing their hierarchy, see Paris, December 1, 1995, *Rev. Arb.* 1996, 456.

[78] Cf. *supra*, pp. 78–79, as well as definition clauses, *infra*, Chapter 3, pp. 153–156.

out conditions precedent (such as the receipt of an authorization) subject to which the contract will take effect.

Although provisions of these types would be more appropriately included in the body of the contract, legal systems rarely favor form over substance. As such, sloppiness by contract draftsmen will not lead to such provisions being deprived of their normal legal effects.[79]

This was the conclusion reached by the Rennes Court of Appeal in 1984.[80] A group of traders entered into an agreement to form a limited company with a view to running a shopping arcade. The recitals to this contract included a passage in which the parties agreed not to modify their initial assortment. This statement was not included in the body of the agreement. The critical issue was to determine whether the statement in the recitals could establish contractual obligations. The Rennes Court of Appeal decided in the affirmative:

> "Considérant que le contrat de société forme un tout dont il n'est pas possible de dissocier la partie "préambule" pour lui donner une simple valeur explicative d'une convention allant suivre;
>
> "Qu'il suffit pour s'en persuader de constater que cette partie contient non seulement l'énoncé de principes généraux devant présider au fonctionnement de la galerie marchande mais aussi celui de toute une série d'obligations précises (dont celui de ne pas "modifier l'assortiment initial") pesant sur des associés présents ou futurs; qu'en signant une telle convention ces associés adhéraient à un contrat dont le préambule était partie intégrée, ayant valeur conventionnelle et dont l'homogénéité implique que toutes ses composantes soient soumises en cas de difficultés à la procédure d'arbitrage stipulée par l'article 57 du contrat."

One should also note that in the first of these two paragraphs, the Court recognized the recitals to have at least an explanatory role, that is to say, a role in interpreting the contract.

In cases where recitals appear to record a true contractual obligation, care should be taken to ascertain whether the relevant provision is repro-

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[79] Compare this with the similar situation in which, *mutatis mutandis, res judicata* will apply with respect to statements made in the passages of a court opinion which set out the reasons for the judgement (cf. *supra*, p. 86).

The law applicable to the contract may affect this matter. Concerning English law, cf. A.G.J. Berg, *op. cit.*, pp. 53–54.

[80] Rennes, Sept. 26, 1984, *Rev. Arb.*, 1986, 441.

duced and elaborated in the body of the contract. Sometimes recitals summarize certain obligations that will be contained in the contract. In such a situation, the provision contained in the body of the contract is, as a matter of principle, the source of the relevant obligations. But the method is dangerous, because of the risk of contradiction. This comes back to the issue of contract interpretation dealt with above.[81]

9. *Simulated Transactions—Obligations in Favor of Third Parties*

We have already referred to instances in which recitals contain statements intended to incur benevolence on the part of third parties such as tax authorities, competition law enforcement authorities or a foreign government.[82]

If such statements are not consistent with reality, the issue of how the legal system in question deals with simulated transactions becomes relevant. With regard to the relationship between the parties to the contract, their real intentions generally prevail, notwithstanding what their apparent intentions are expressed to be. However, to avoid future dispute, it is advisable that the parties sign a side-letter (*contre lettre*) although there is always the risk, at least under French law (Article 1321 of the French Civil Code), that third parties will have relied upon the false statement in the recitals and may enforce their rights accordingly. One should also bear in mind that such simulation often amounts to fraud and is therefore often unlawful.[83]

In other instances, passages are included in recitals that are intended to be read by third parties with no aim to mislead. They simply re-state the terms of an agreement resulting from previous negotiations with such third parties. For example, acquiring shares in an insolvent company may be authorized by the relevant public authorities only in return for assurances about maintaining employment for the company's employees.[84]

Could not recitals, which confirm such assurances and which are published (for example when they are used in a press release), amount to undertakings enforceable by third parties, a government or trade union having some interest in the transaction?

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[81] Cf. *supra*, pp. 88–90. See, however, Christou's suggestion to include a clause in the operative part confirming the obligations stated in the recitals (R. Christou, *Boilerplate practical clauses*, 2nd ed., Londres, FT Law & Tax, 1995, p. 5).

[82] Cf. *supra*, p. 67.

[83] With regard to simulated transactions under French law see, J. Ghestin, Chr. Jamin & M. Billiau, *Traité de droit civil, Les effets du contrat*, Paris, L.G.D.J., 3rd ed., No. 865–921.

[84] Cf. *supra*, pp. 79–80.

10. Contractual Provisions on the Effects of Recitals

The various legal effects of recitals described above may arise if the contract contains no express provision stating the effects which its recitals are to have.

It is very rare for parties to make express provision as to such effects. Here is an example where this was done, taken from a Japanese Distribution Agreement:

> "Article XXII—Entire Agreement.
>
> "This Agreement constitutes the entirety of the covenants between the parties hereto with respect to the matter hereof. It supersedes and cancels any and all previous covenants, agreements, distributorship rights and undertakings either writing or verbal. It may not be amended except by an agreement in writing established between the parties and signed by their respective duly authorized officers.
>
> "The recital of this Agreement shall have same force and effect as the text hereof."
>
> Here are the recitals to the Agreement:
>
> "Whereas A manufactures and sells the automotive products known as . . . and desires to establish and develop the market for its products in the territory defined, and
>
> "whereas the Distributor is willing to purchase . . . to import them into the above territory for distribution, and
>
> "whereas the parties now wish to fix the terms and conditions of their relationship and agree to bind themselves by this Agreement, which supersedes and cancels any and all previous covenants, agreements and undertaking, either verbally or in writing, which may conflict, amend or abridge the terms and conditions hereinafter set forth.
>
> "now, therefore, in consideration of the premises and the mutual undertakings herein contained, the parties hereto agree as follows: . . ."

What can be the legal effect of wording such as this, which provides for the recitals having the same force and effects as the body of the contract? One may wonder whether such wording adds anything at all to what has been said above. The only parts of recitals, which can have the same effect as provisions contained in the body of the contract, are those that

amount to operative provisions, which would be more appropriately contained in the body of the contract (for example, the third paragraph of the recitals quoted above, which supersedes and cancels all previous agreements between the parties). In any event, provisions that describe the parties ("A manufacturers and sells automotive products") or their objectives. ("A . . . desires to establish and develop the market for its products . . .") clearly cannot amount to operative provisions in the same way as those contained in the body of the contract in spite of any provision that purports to give them the same force and effect as provisions contained in the body of the contract.[85]

Conversely, Grosheide wonders what to think about the following hypothetical clause that this author thought up for the purpose if his article.[86]

> "The recital of this agreement shall have no force and effect whatsoever and may not be taken into account as an aid to construction."

Quite rightly, Grosheide refers to the legal effects of entire agreement clauses. The above clause has similar purposes by retraining the interpretation capacity of a judge or an arbitrator. The analysis of substantive and evidential law in the following chapter on interpretation clauses[87] seems to be relevant to this hypothetical clause.

V. ADVICE TO NEGOTIATORS

The legal effects that may result from recitals should not be underestimated. In a variety of ways, recitals can have important repercussions for a contract and for its parties.

For this reason, particular care should be taken when drafting recitals. In practice, this does not always happen; some contract draftsmen become

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[85] Two Italian authors have suggested the following clause in an attempt to find a compromise between the binding force of the recitals and the priority to be given to the operative part: "Now, therefore, in accordance with the foregoing recitals which are an integral part of this Agreement and which are subject to the detailed terms and conditions hereinafter set forth, ITALIA and ELECTRONIC SERVICES agree as follows: . . ." (M. Bianchi & D. Saluzzo, *I contratti internazionali, Techniche di redazione e clausole contrattuali*, Volume 1, Milan, Il sole 24 ore, 32). Such a clause seems to have the disadvantage not to oblige drafters to clearly distinguish between, on one hand, what they consider to be the hard core of contractual undertakings and on the other hand statements pursuing different purposes. However, the suggested clause could be useful in a system like the English one, where courts have formulated principles of interpretation liable to reduce the effets of recitals. The clause would then tend to protect drafters, thus giving more flexibility in negotiations.

[86] F.W. Grosheide, *op. cit.*, p. 321.

[87] Cf. *infra*, Chapter 3, pp. 105–119.

less rigorous when drafting this introductory part of a contract and make it appear more a work of literature than a legal document. This Chapter concludes with a checklist:

1. Recitals are rarely a necessity. A contract without recitals is, in principle, entirely valid. The inclusion of recitals should not result from a desire to merely follow a certain tradition. Rather, it should be the result of a conscious decision. Are the provisions, which are intended to be put in the recitals, liable to produce desirable legal effects or could they increase the risk of future disputes between the parties?

   Each party to a contract will not always give the same response to these questions and it may be that the parties have conflicting interests in relation to certain provisions in the recitals. This justifies the same degree of care in negotiating recitals as that given to the negotiation of the body of the contract. Particular care should be given when determining the appropriate part of the contract in which various provisions are to be inserted. This should be decided according to the nature of the provisions in question.
2. The most widespread effect of recitals is to serve as an authoritative aid to the interpretation of a contract.[88] This should be borne in mind when describing the circumstances surrounding the entering into the contract and the objectives pursued by the parties. Such descriptions will undoubtedly be in the basis for any future discussions between the parties in relation to issues of interpretation of provisions contained in the contract. In addition, they will be closely scrutinized by judges or arbitrators called upon to adjudicate any dispute concerning interpretation.
3. When it proves necessary to record that a certain fact is true, is acknowledged by a party to be true or is known by a party, either to prevent a future dispute, or on the other hand, to provide the basis for a possible future claim, recitals can be the appropriate place.
4. Using the recitals to describe the circumstances, which have led up to the making of the contract, can be important for a party who wishes to challenge or amend its obligations under the contract if these circumstances change, governing law (or hardship clause) permitting.
5. A party who wishes to obtain performance of superior quality from the other party to the contract is likely to use the recitals to highlight the particular skills and attributes of the party who is to supply such performance.

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[88] Thought should be given to the important differences which exist in this regard between the various legal systems (see *supra*, pp. 88–91).

6. If negotiations leading up to the contract have been long and have led to the exchange of a considerable number of pre-contractual documents, it may be appropriate to record it in the recitals, listing such documents. It would be appropriate to clarify—preferably in the operative part of the contract[89]—the effects parties wish or do not wish the pre-contractual documents to have.
7. If a contract is economically linked to other contracts, it may be useful to state this in the recitals with the possible aim of providing an aid to interpretation. It may, however, be debatable whether such a statement creates any legal linkage between the different contracts; in any case, it is certainly preferable to state in the body of the contract whether such linkage exists or not.
8. The appropriate place for operative provisions is the body of the contract and it is suggested that such provisions should not be contained in recitals (cf. above, recommendations 6 and 7).[90]

   Using recitals to summarize obligations, which are more fully dealt with in the body of the contract, should be avoided because of the possibility for dispute over interpretation in the event of inconsistency between the recitals and the relevant operative provisions. At the very least, the recitals should specify that the obligations, which they summarize, will be undertaken and performed in accordance with the provisions contained in the body of the contract.

   By the same token, to avoid problems of interpretation, provisions giving the recitals the same force and effects as those contained in the body of the contract should be avoided.[91]
9. Some provisions contained in recitals may be intended to supply information to governmental or administrative bodies. Even though such provisions do not alter the basic philosophy of the contract, there is nonetheless a danger that they may one day justify unexpected consequences, for example when a judge or arbitrator is called upon to interpret the contract. Sending a side-letter may be a precaution worth taking.

Recitals to contracts should receive more attention in legal literature than has been the case. In most countries, until recently, they were given almost no attention at all. Recitals are extremely widespread and can have a multitude of legal effects.

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[89] For an identical view, cf. E.A. Farnsworth, The Interpretation of International Contracts and the Use of Preambles, *I.B.L.J.*, 2002, pp. 271–279.

[90] Cf. P. Siviglia, *Commercial Agreements*, West, 1997, § 1.2. Compare, however, the contrary opinion of some Canadian and American authors, who, in the context of contracts governed by the Vienna Convention on International Sales of Goods, argue that any such provisions may as an alternative negotiation strategy be incorporated in the recitals (J.M. Klotz & J.A. Barrett, *International Sales Agreeements*, La Haye, Kluwer Law International, 1998, pp. 46–49).

[91] Compare R. Christou, *op. cit.*, p. 5.

CHAPTER 3

INTERPRETATION CLAUSES

I. WORKING METHOD

True to its objectives, the Working Group on International Contracts looked at interpretation clauses in international commercial contracts from the perspective of international contract draftsmen. On the basis of discussions and analyses of sample clauses provided by its members[1] working

[1] Also, the following interpretation clauses contained in international instruments may be mentioned:

Articles 2 and 26 of the ICC Model Commercial Agency Contract, ICC Publication No. 644, Paris, ICC Publishing, 2002;

Articles 2 and 26 of the ICC Model Distributorship Contract, ICC Publication No. 646, Paris, ICC Publishing, 2002;

Article 1.1, 1.3, 1.4 and 1.5 of the ICC Model International Sale Contract, ICC Publication No. 556, Paris, ICC Publishing, 1997;

Articles 1 and 2 of the ICC Occasional Intermediary Contract, ICC Publication No. 619, Paris, ICC Publishing, 2000;

Rules 1.03, 1.09 and 1.11 International Standby Practices ISP 98, ICC Publication No. 590, Paris, ICC Publishing, 1998;

Chapter IV—General remarks on drafting of the Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works, UNCITRAL, U.N. Sales No. E.87.V.10, document A/CN.9/SER.B/2, 1988, pp. 46–49;

Chapter IV—General remarks on drafting of the Legal Guide on International Countertrade Transactions, UNCITRAL, U.N. Sales No. E.93.V.7, document A/CN.9/SER.B/3, 1993, 46–49 and 51;

Articles 2.1, 14.2 and 14.4 of the European Model EDI Agreement, see Commission Recommendation 94/820 of October 19, 1994 relating to the legal aspects of electronic data interchange, OJ L. 338 of December 28, 1994, pp. 98–117;

Clauses 1, 2 and 36 of the Client/Consultant Model Services Agreement—The White Book, FIDIC, Lausanne, second edition, 1991; Conditions of Contract for Electrical and Mechanical Works—The Yellow Book, FIDIC, Lausanne, 3rd edition 1988 (clauses 1.1–1.3 and 5.1–5.4); Conditions of Contract for Works of Civil Engineering Construction—The Red Book, FIDIC, Lausanne, 4th 1989 (clauses 1.1–1.4 and 5.1–5.2);

Guide to the use of FIDIC's Sub-Consultancy and Joint Venture (Consortium) Agreements, FIDIC, Lausanne, 1994 (clauses 1.1–1.2 and 2.3–2.5 of the Sub-Consultancy Agreement and clauses 1.1–1.2, 11 and 21 of the Joint

in legal or contract departments of companies or working in private practice, general trends and problems regarding these clauses were observed.

An analytical way of describing interpretation clauses is used since this has the advantage that the various elements of these clauses are emphasized and are given extensive attention. The disadvantage is that these elements are too much isolated from one another and that their intrinsic links are insufficiently stressed. To fully understand interpretation clauses, one should seek an overall perspective including their various elements, their context, the applicable law and the factual background of the circumstances in which these clauses have been or are to be used. The analytical approach also has the disadvantage that the breaking down of interpretation clauses into 12 different categories (see Section III) may pay insufficient attention to their inter-relationships. The analytical method has, however, the advantage that the various interpretation mechanisms are better identified and described by emphasizing their different features. However, this approach isolates the various aspects of interpretation clauses from one another and, therefore, sketches only an incomplete picture since many interpretation clauses bring together various elements. For that reason, the examples cited hereafter should not be seen as sample interpretation clauses but are used only to illustrate the various elements that have been found in this study.

Attempts to classify interpretation clauses (see Section III) may create an impression that all interpretation clauses fall within one of these categories. Classification only seeks a better grasp of the wide variety of interpretation clauses that were encountered during the project and to provide an outline of the options available to contracting parties; it cannot be all-inclusive.

Some interpretation clauses in international commercial contracts tend to be standardized to a large extent; their contents and wordings are often similar. Such clauses may be characterized as *boilerplate clauses* that are copied from one contract to another not only within the same company or law firm but also across the legal profession and across borders. The degree

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Venture (Consortium Agreement); Conditions of Subcontract for works of Civil Engineering Construction, FIDIC, Lausanne, 1994, 1st edition (clauses 1.1–1.4, 3.1 and 3.4); Conditions of Contract for Design—Build and Turnkey—The Orange Book, FIDIC, Lausanne, 1st edition, 1995 (clauses 1.1–1.6). In relation to the FIDIC Conditions, one should also note the publication by FIDIC at the end of 1999 of four new standard forms of contract: (1) the Short Form of Contract; (2) Conditions of Contract for EPC ("Engineer, Procure, Construct") Turnkey Projects; (3) Conditions of Contract for Plant and Design-Build; and (4) Conditions of Contract for Construction (Lausanne, FIDIC, 1st edition, 1999). Some provisions of the old FIDIC conditions are cited in this chapter as examples only.

of standardization of some interpretation clauses is comparable to some other contract clauses (e.g., assignment clauses[2]). This may be explained by the fact that interpretation clauses are much less tailor-made than some other contract clauses that are related to the core of the contract.[3] Interpretation clauses are often standard terms incorporated at the beginning or the end of contracts and not the subject of negotiations between the parties. Another reason for the standardization of interpretation clauses may be the influence of Anglo-American drafting techniques for international contracts. Often used by U.S. or U.K. law firms and companies, these clauses appear in contracts where parties from the United States or the United Kingdom are involved or where U.S. or U.K. law firms were retained. Sometimes, these sophisticated clauses are considered as the *state of the art* of contract drafting and are used also where the United States or the United Kingdom are not involved, for instance if English is the negotiation and contract language.

II. DIFFERENT CONTRACT INTERPRETATION MODELS

Before embarking on an analysis of interpretation clauses, a preliminary issue should be addressed as to the view different legal systems and uniform law take as to the interpretation of contracts concerning some basic principles of contract law such as autonomy of the parties, interference by courts in contractually binding instruments and standards of good faith, fair dealing, reasonableness and equity.[4] The following issues need to be addressed:

1. What is the contractual content upon which the parties have agreed and how is any such content to be determined in cases where one party alleges that there are terms other than the written terms of the contract which add to, vary or contradict these terms;
2. How is any such content to be construed if it leads to different interpretations by the parties owing to ambiguities;
3. Are obligations other than those agreed upon by the parties read into the contract and which techniques are used to that effect;
4. How are gaps in the contractual regulation dealt with;

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[2] See Chapter 11, pp. 537–538.

[3] For instance termination clauses, see Chapter 12.

[4] In common law countries, principles of contract interpretation have been developed by case law. In the United States, there is also the impact of the Uniform Commercial Code. In civil law countries, codified interpretation rules are the starting point of the analysis. By way of examples, one may cite Articles 1156–1164 of the French and Belgian Civil Codes, Articles 2 and 248 of Book 6 of the Dutch Civil Code, Articles 1364–1371 of the Italian Codice Civile, Sections 133, 157 and 242 of the German Civil Code, Article 2 of the Swiss Civil Code and Article 18 of the Swiss Code of Obligations.

5. Are contracts immutable or adaptable in case of changed circumstances; and
6. Are contractual rights to be enforced rigidly or are they mechanisms to correct the exercise of those rights.

Furthermore, these basic contract law issues should not only be analyzed from the mere perspective of substantive law but should also be addressed from an evidence angle. As will become clear from the analysis below (see Section II.B), evidence issues may have a bearing upon substantive contract law. This chapter will first discuss the substantive issues and thereafter the impact of evidence law on substantive law.

A. Substantive Law

When solving basic substantive contract issues, one might first draw a distinction among the dispute settlement methods chosen by the parties. The application of contract law rules may indeed differ between mediation (or other forms of alternative dispute settlement), arbitration and court litigation. In the first case, the amicable settlement of the dispute governs, and the parties may, often with the support of a mediator who cannot render binding opinions, depart from contract law rules in order to terminate a dispute on the basis of the terms of the settlement on which they agree.

In arbitration, particularly in international commercial arbitration, legal standards control,[5] but one should not underestimate the importance of psychological and practical considerations in the adjudicatory process.[6] In any event, one notes an obvious tendency that commercial arbitrators, because of the contractual nature of arbitration, refuse to depart from the contract terms and are not readily inclined to derogate from contractual provisions on the basis of fairness. This is confirmed by many arbitrations laws, uniform texts and arbitration rules, which explicitly impose that arbitrators should pay due regard to contract clauses.[7] On the other hand, the discretion offered to arbitrators under recent arbitration laws and the fact that arbitral awards are not reviewed on their merits explains why arbitrators obliged to apply rules of law (as opposed to *amiable composition*) have more flexibity in interpreting contracts than domestic courts have. These possibilities for arbitral adjudication (*lex mercatoria*[8]) will, as such, not be

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[5] See for instance, M.H. Maleville, Pratique arbitrale de l'interprétation des contrats commerciaux internationaux, *R.D.A.I./I.B.L.J.* 1999, pp. 100–110.

[6] F. De Ly, Uniform commercial law and international self-regulation, in *The Unification of International Commercial Law*, F. Ferrari, (ed.), Baden-Baden, Nomos Verlag, 1998, 60–61; also published in 11 *Dir. Com. Int.*, 1997, pp. 519–547.

[7] See F. De Ly, *International Business Law and Lex Mercatoria*, Amsterdam, North-Holland, 1992, pp. 117–120.

[8] On this third approach to *lex mercatoria*, see F. De Ly, Lex Mercatoria (New Law

able to completely settle interpretation disputes on the basis of non-national principles such as *pacta sunt servanda* and, therefore, disputes between companies in relation to interpretation will generally have to be solved by recourse to national law.[9]

Secondly, attitudes towards freedom of the parties, application of objective standards of conduct and court intervention vary significantly between different jurisdictions as to their theoretical assumptions and basic ideas, but less so in relation to practical applications.[10] One of the problems causing differences and confusion is related to the proper definition of the concept of interpretation. In some countries interpretation is the process whereby the common intention of the parties is determined (*subjective theory*). In other countries, interpretation is the process of determining the rights and obligations of the parties, primarily if there are ambiguities, contradictions or gaps within the contents of the contract (*objective theory*).[11] This process takes place based on a number of factors such as good faith and fair dealing, state of the art, trade usages, course of dealing or industry standards, including but not limited to the parties' common intentions. Under the objective theory, the subjective theory is absorbed and at the same time the parties' common intentions are reduced to only one factor when determining the contents of the contract. The major issue under that theory is then to establish when and to what extent these intentions still have a role to play including their effect on objective standards of adjudication. Finally, there is a third group of countries where a sharp distinction is made between the common intention of the parties and objective rules for contract interpretation (*mixed theory*). If the common intention can be established, that intention will prevail. Objective interpretation will come into play if and to the extent that the common intention cannot be determined, but then there is no longer any room for what the parties might have intended had they envisaged the problem.

In civil law countries, the starting point is freedom of contract and the subjective intent of the parties (*subjective theory*). Contracts are formed by the meeting of the parties' minds, and contract interpretation is aimed at discovering what the parties meant when concluding the contract or at the

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Merchant): Globalization and International Self-Regulation, in *Rules and Networks*, V. Gessner, (ed.), Hart, Oxford, 2001, pp. 159–188; also published in 14 *Dir. Com. Int.* 2000, pp. 555–590.

[9] This may be different in State contract-litigation where States and public enterprises are involved.

[10] See H. Kötz, *Europäisches Vertragsrecht*, I, Tübingen, Mohr, 1996, pp. 165–173, translated in H. Kötz, *Interpretation of Contracts, in Towards a European Civil Code*, A. Hartkamp, et al. (eds.), 2nd edition, The Hague, Kluwer Law International, 1998, pp. 267–283.

[11] H. Kötz, *op. cit.*, 163.

least what they would have agreed upon if the problem to be solved had crossed their minds.

This position is still to a large extent to be found in French contract law theory[12] and in the legal principles developed by the French Supreme Court.[13] However, in French legal practice, results are often achieved that are similar to those in other civil law systems although the theoretical paradigms of contract law have not been changed. This is particularly so in relation to objective standards of fair dealing that are important in French contract law but are phrased and hidden under a different terminology. For instance, case law of the French Supreme Court—on the basis of Article 1134 of the French Civil Code (party autonomy)—has extended review as to the interpretation of contracts[14] to those contractual provisions that are clear and precise (*clauses claires et précises*).[15] In those cases, lower courts can be reversed if they did not apply these contractual clauses (*dénaturation*). Thus, the Supreme Court accepted limited review in contract interpretation issues based on the need for legal certainty resulting in a strict enforcement by lower courts of contract provisions on the basis of a strict reading of contracts thereby excluding arguments as to the contracts not complying with what the parties really intended.[16] Also, French contract law recognizes a lot of contractual obligations that are not explicitly stated in the contract but are read into it. On the basis of Article 1135 of the Civil Code, the scope of contractual commitments is not limited to the express contract terms but also extends to all those consequences that must be considered to be part of the contract by virtue of statute, custom and fair dealing (*équité*). French case law and scholars have, in a very pragmatic way, incorporated many obligations into contracts by means of this technique (such as the obligation to inform, to give advice, to warn or to give implied warranties) without challenging the traditional party autonomy paradigm.[17] Similarly, a general principle of law, under which no one

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[12] Gradually, French contract law theory is exploring the possibilities and limits of good faith and fair dealing and equity as general principles of contract law, see Y. Picod, *Le devoir de loyauté dans l'exécution du contrat*, Paris, L.G.D.J., 1989, 254 pp.; C. Albiges, *De l'équité en droit privé*, Paris, L.G.D.J., 2000, 383 pp.; B. Jaluzot, *La bonne foi dans les contrats, Etude comparative de droit français, allemand et japonais*, Paris, Dalloz, 2001, 605 pp.

[13] See B. Mercadal, *Contrats et droits de l'entreprise*, Paris, Francis Lefebvre, 2002, pp. 321–325.

[14] In principle, review is excluded because interpretation of contracts is a matter of fact-finding and not a legal issue.

[15] See M.H. Maleville, *L'interprétation des contrats d'assurance terrestre*, Paris, L.G.D.J., 1996, pp. 94–100 and pp. 117–122.

[16] See on all these aspects M.H. Maleville, *Pratique de l'interprétation des contrats*, Etude jurisprudentielle, Rouen, Publications de l'Université de Rouen, 1991, 319 pp.

[17] See, on the basis of a comparison with German law, A. Rieg, *Le rôle de la volonté dans l'acte juridique en droit civil français et allemand*, Paris, L.G.D.J., 1961, 589 pp.

may abuse his legal rights, has easily found its way in to contract law in order to enable courts to interfere with contractual cases where evident fraud or manifest abuse were present (*abus de droit*).[18] In cases of changed circumstances, however, French contract law has not developed (*imprévision*). Here, in civil and commercial contracts, the principle is that contracts are binding and immutable even when significant changes occurred after the conclusion of the contract that dramatically affected the contract. Although the maxim *clausula rebus sic stantibus* had been accepted at the beginning of the last century for administrative contracts, this principle has not been extended to civil and commercial contracts. Thus, the contracting parties must provide for hardship clauses if they want contracts to be modified on the basis of changed circumstances.[19]

In Belgium, contract law is very similar to French law except that the theories of the *clauses claires et précises* and *dénaturation* have not developed in the same way as in France. In this respect, the practice of review by the Belgian Supreme Court is more limited and extends only to review whether the trial judge gave an acceptable motivation for his decision. In that respect, interpretation may not result in conclusions that are neither suppported by the agreement in writing nor by the real intentions of the parties.[20] Moreover, in commercial transactions (between merchants or in an action against a merchant), evidence contradicting the written agreement may be brought since evidence in those transactions is free and not subject to the restrictive provisions of the Civil Code. Also, abuse of contractual rights is not based on a general principle of law but rather on a provision of contract law stating that contracts are to be performed in good faith (Article 1134, third paragraph Belgian Civil Code). However, the fact that the basis for abuses is different from the French one does not lead to substantially different consequences. Finally, it is to be noted that the Dutch-speaking scholars primarily influenced by Dutch law are proposing to acknowledge the relevance of objective standards of conduct in contract interpretation, filling of gaps and restrictions regarding the attitudes of contracting parties in exercising their contractual rights.[21]

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[18] On abuse and contract law, see Ph. Stoffel-Munck, *L'abus dans le contrat*, Paris, L.G.D.J., 2000. Absent abuse, contractual rights are to be enforced and lack of fairness (*équité*) is not a reason to refuse to do so (M.H. Maleville, *op. cit.*, 93). On abuse of contractual rights and equity, see C. Albiges, *De l'équité en droit privé*, Paris, L.G.D.J., 2000, 383 pp.

[19] See Chapter 9.

[20] R. Kruithof, in R. Kruithof, H. Bocken, F. De Ly, & B. De Temmerman, *Overzicht van rechtspraak (1981–1992)*, Verbintenissen, Tijdschrift voor Privaatrecht, 1994, pp. 448–449.

[21] See F. De Ly, *De lex mercatoria*, Antwerp, Maklu, 1989, pp. 287–289. As in France, one also witnesses a development with Belgian French-speaking authors towards a more objective contract law theory, see J.F. Romain, *Théorie critique du principe de bonne foi en droit privé*, Brussels, Bruylant, 2000, pp. 797–959.

During the meetings of the Working Group, it was reported that the above-mentioned position of French and Belgian law is also found to a large extent in Italy, Spain, Portugal and Brazil.

The theoretical position is different in Germany where, in the 1920s, courts intervened in contract cases in three major respects based on the notion of good faith and fair dealing (Section 242 of the German Civil Code—*Treu und Glauben, objective theory*). First, courts read new obligations into contracts and, thus, have supplemented what the parties had already provided (*Ergänzungsfunktion*). Secondly, good faith may be used to interfere with contract terms and prohibit the exercise of contractual rights if this conflicts with fair dealing (*Schrankenfunktion*). Finally, contracts may be adapted to new circumstances by courts as a result of a significant change in the circumstances that originally led to the conclusion of the contract (*Korrekturfunktion*).

Similar developments took place in The Netherlands[22] where, in the new Civil Code, good faith was re-baptized as reasonableness and fairness in order to express much better the reference to an objective standard of conduct and not to a subjective intention of the mind such as honesty in fact. Therefore, good faith as a subjective element was distinguished from reasonableness and fairness that, under the new Civil Code introduced for contract law on January 1, 1992, is a standard under which judges may review contractual conduct, supplement contract terms and revise contracts (for the latter see Article 258, Book 6 Dutch Civil Code).

Influences of the objective theory are also to be found in Switzerland on the basis of Article 2(1) of the Civil Code,[23] particularly under influences from Germany and through the German-speaking scholars. However, it seems that Switzerland has an interesting mixture of subjective and objective models since, first, an inquiry will be made as to the real intentions of the parties and subsequently—if no clear common intention can be established—objective standards will be applied. The first stage of the inquiry is factual and without review by the Swiss Supreme Court, whereas the second stage of the analysis is deemed to be of a legal nature and is reviewable. The Swiss position has the advantage that its two-stage approach not only reconciles both the subjective and objective models but also gives a practical solution as to how this reconciliation is to be effected.[24]

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[22] See J. Van Dunne, *Verbintenissenrecht*, Part 1, Deventer, Kluwer, 2001, pp. 137–236.

[23] See E.M. Belser, Die Auslegung des Vertrages, in *L'européanisation du droit privé*, Fribourg, Editions universitaires, 1998, pp. 237–267.

[24] A similar approach is also found in Article 4.1 of the Unidroit Principles and Article 5:101 of the Principles of European Contract Law. Egyptian law also seems to take this two-tier approach.

The situation in the Germanic civil law countries,[25] has undoubtedly but subtly influenced the United States,[26] particularly the Uniform Commercial Code. Through Karl Llewellyn, Chief Reporter for the Uniform Commercial Code, the UCC borrowed from German law notions such as good faith or fair dealing.[27] The theoretical ramifications of any such borrowings have, however, insufficiently been analyzed,[28] and no lessons have yet been drawn from any such influence. Examples of objective standards under which contracts may be reviewed include UCC Section 2-302 (unconscionable contracts or clauses), Section 2-305 (open price contracts) or Section 2-306(1) (output and requirement contracts).[29] In accordance with UCC Section 1–102(3), the standard of good faith may not be varied by agreement, but does not exclude that the parties determine reasonable standards against which to measure the performance of the obligation.

Uniform law texts have been more ambiguous about their approach to freedom of contract and contract interpretation. Within the European Union, general contract law has hardly been the subject of directives except for the Commercial Agency Directive[30] and therefore no generalizations can be made at this point. Also, specific directives in the fields of consumer protection (such as the Unfair Contract Terms Directive[31]) or employment contracts have not yet sufficiently matured to draw conclusions as to general positive contract law principles within the European Union. On a worldwide scale, there is primarily the U.N. Convention on the International Sale of Goods (CISG) that in view of the number of contracting states and its practical relevance, should be taken into account. In this respect, CISG is tainted by compromises between hard and fast rules

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[25] For the purposes of this analysis, Switzerland and The Netherlands may be characterized as belonging to the Germanic legal tradition.

[26] In relation to a recent similar development in Australia, inspired by U.S. law and the Unidroit Principles, see A. Mugasha, Evolving Standards of Conduct (Fiduciary Duty, Good Faith and Reasonableness) and Commercial Certainty in Multi-Lender Contracts, *Wayne L. Rev.* 2000, pp. 1789–1824.

[27] A. Farnsworth, Duties of Good Faith and Fair Dealing under the Unidroit Principles, Relevant International Conventions, and National Law, *Tul. J. Int. Comp. L.* 1994, pp. 51–52.

[28] Cf. A. Farnsworth, *loc. cit.*, pp. 59–61.

[29] For the latter, see J. Gordley, An American perspective on the Unidroit Principles, Saggi, Conferenze e Seminari, Rome, Centro di studi e richerche di diritto comparato e straniero, 1996, p. 3.

[30] Directive 86/653 of December 18, 1986 on the approximation of the laws of the Member States regarding independent commercial agents, OJ L. 382 of December 31, 1986, pp. 17–21.

[31] Directive 93/13 of April 5, 1993 on unfair contract terms in consumer contracts, OJ L. 95 of April 21, 1993, pp. 29–34.

regarding the binding character of sales and some open-ended rules regarding contract interpretation as is the case with regard to the legal status of usages (Articles 8(3) and 9 CISG), good faith (Article 7(1) CISG) or open price contracts (Articles 14 and 55 CISG).

The Germanic and U.S.-UCC approaches to contract law have also influenced the Unidroit Principles of International Commercial Contracts[32] as well as the Principles of European Contract Law (hereafter referred to as the PECL).[33] These *Restatement*-type efforts[34] have been based on comparative law analysis and have finally opted for quasi-legislative techniques much more inspired by the style and notions of the Germanic legal tradition and of the UCC than of the Romanic, English or other legal traditions.

Finally, in England contract law interpretation has, to a large extent, remained focused on both freedom of contract and literal exegetic interpretation, provided the latter does not lead to absurd consequences.[35] With regard to the former, the situation is different from all other legal systems discussed above. Under English contract law, judges have refused to admit

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[32] *Principles of International Commercial Contracts*, Rome, Unidroit, 2004, 385 pp.; for a commentary with further references, see M.J. Bonell, *An International Restatement of Contract Law, The Unidroit Principles of International Commercial Contracts*, Irvington N.Y., Transnational, 2nd ed. 1997, 572 pp.

The influence of an objective theory of contract law may be seen in Articles 1.7 (acting in good faith and fair dealing), 2.1.15 (negotiations in bad faith), 3.5 (mistake), 3.10 (gross disparity), 4.8 (addition of contract terms based on good faith and fair dealing) and 7.1.6 (exemption clauses). For a discussion, see A. Farnsworth, loc. cit, pp. 47–63.

In relation to interpretation, Article 4.1 provides that a contract must be interpreted according to the common intentions of the parties and, absent any such intentions, in accordance with the meaning that reasonable persons of the same kind as the parties would give it in the same circumstances (see also Articles 4.2 and 4.3).

[33] Commission on European Contract Law, *The Principles of European Contract Law, Parts I and II*, Lando, O. & Beale, H. (eds.), The Hague, Kluwer Law International, 2000, 561 pp. The influence of good faith is clear from Articles 1:102(1), 1:106(1), 1:201(1), 1:302, 2:301 and 6:102. The influence of the objective theory is clear in Article 5:101(3) which contains language similar to that of the Unidroit Principles.

[34] There are, however, differences with the U.S. Restatements as to the organizations promoting these texts and the scope of these efforts. In this respect, the U.S. Restatements are based on common foundations and principles within the U.S. legal system which is not or to a lesser extent the case on a worldwide scale regarding the Unidroit Principles or within the European Union regarding the PECL. For a criticism regarding these Restatement-like efforts, see C. Kessedjian, *Un exercice de rénovation des sources du droit des contrats du commerce international: les Principes proposés par l'Unidroit*, R.C.D.I.P., 1995, pp. 641–670.

[35] See K. Lewison, *The Interpretation of Contracts*, 2nd ed., London, Sweet & Maxwell, 1997, 460 pp.; M. Anderson, *Drafting and Negotiating Commercial Contracts*, London, Butterworths, 1997, pp. 87–88; A.G.J. Berg, *Drafting Commercial Agreements*, London, Butterworths, 1991, pp. 73–80.

that they imposed additional obligations on contracting parties because it was fair or reasonable to do so. Rather, contract supplementation has been based on the doctrine of *implied terms*,[36] which—apart from implications by law or as a matter of necessity—hides in hypothetical party-intent terms that the judges are imposing additional contract terms because—in their opinion—this solution is reasonable and fair under the circumstances. Also, the English judiciary has been reluctant to intervene in contractual relations and to derogate from contract terms on the basis of notions such as good faith or fair dealing. Finally, contracts cannot be revised under English law in the case of changed circumstances, which make it more difficult for one of the parties to perform except if the restrictive requirements of the doctrine of *frustration* are met. In this respect, English law is more predictable than contract law in other systems. Unlike the civil law countries, English contract law does not interpret contracts by looking to party intent but rather to what the parties have expressed and written down. Contracts are primarily interpreted on the basis of an exegetic reading of written instruments. This literalist position may be changing towards a more objective (commercially oriented, contextual and purposeful) perspective[37] as appears from recent case law of the House of Lords,[38] but there is still opposition against this recent development within the legal profession and even within the House of Lords. In any event, the tradition of literal interpretation of contracts is typically English and is not found in the other jurisdictions under discussion. On the other hand, like France by virtue of the theory of clear and precise clauses, English judges will not proceed to interpretation of unambiguous clauses on the basis of the *plain meaning* rule.

From the foregoing analysis, it appears that national legal systems, uniform law and international commercial arbitration may take different approaches to contract interpretation. These variances are often due to different assumptions but do not always result in very big differences in practical solutions. To this, there are some exceptions such as hardship[39] or the

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[36] The basic House of Lords case on implied terms is *Liverpool City Coucil v. Irwin* [1977] A.C. 239.

[37] G. McMeel, The Rise of Commercial Construction in Contract Law, *Lloyd's Mar. Com. L.Q.* 1998, pp. 382–392.

[38] *ICS v West Bromwich Building Society* [1998] 1 All E.R. 98 (HL). In this case, Lord Hoffman for the majority held that the meaning of the words of a contract is not the same as the meaning that a document would convey to a reasonable man. In this respect, his Lordship stated that interpretation is the ascertainment of the meaning of a document to a reasonable person having all the background knowledge that would reasonably have been available to the parties in the situation in which they were at the time of the contract.

[39] See *infra*, Chapter 9.

somewhat still isolated position of English contract law. In analyzing and drafting interpretation clauses, these different approaches must always be kept in mind.

B. Evidence

So far, the comparative analysis dealt with substantive contract law. However, interpretation of contracts also involves problems of evidence. The problem of contract construction cannot be limited to the effects to be given by judges and arbitrators to contracts but also encompasses the question as to how the contracting parties should prove the contents of their contract. Since the international contracts, which were the object of this research project, were written contracts, the issue that arises is whether and to what extent contracting parties may prove the contents of their contract by relying on written evidence other than the written contract and on other evidence such as witness testimony. In that respect, a further distinction is to be made between admissible evidence regarding (1) ambiguities arising from the contract; (2) gaps to be filled where the written contract does not provide for an answer to the problem at hand because that problem is not dealt with in the contract; and (3) terms agreed upon by the parties other than the terms of the written contract that add to, vary or contradict these latter terms.

Rules on evidence may well be relevant here in order to determine the role of contracting parties, judges and arbitrators to contract interpretation. In international commercial arbitration, recent arbitration laws have introduced liberal rules regarding evidence on issues such as burden of proof, means of evidence and assessment of evidence. In jurisdictions having these liberal rules, the domestic rules for court litigation regarding evidence of the place of arbitration will not be applicable to the arbitration, and the liberal rules will apply. However, the substantive law governing the contract may still have an impact regarding the question whether and to what extent some evidence is admissible.[40]

In jurisdictions having less liberal arbitration statutes or in domestic court litigation, domestic procedural rules on evidence will be much more important. In that respect, a distinction must be dawn between civil law countries having liberal rules, civil law countries having more restrictive rules and common law jurisdictions. First, France, Belgium and The Netherlands have rules on evidence that are generally quite liberal and will not have a substantial impact on interpretation clauses. For France and Belgium with a distinction between general private law and commercial law (*droit civil et droit commercial*), the general principle—subject to exceptions—

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[40] As to conflict of laws issues, see Th. Grout, *La preuve en droit international privé*, Aix-en-Provence, Presses universitaires d'Aix-Marseille, 2000, 422 pp.

is that there are no strict rules on evidence in commercial matters (as opposed to the strict rules in *droit civil*), and that evidence is free. Thus, for commercial contracts, the parties may prove, with any means of evidence, the facts on which they rely, and the judge has the discretion to admit or refuse any such evidence. For commercial contract interpretation, this implies that the parties may—without limits—prove those facts that support their respective positions regarding the scope and effects to be given to the contract when ambiguities, gaps or contradictions arise. This evidence is not limited to the written contract, but also extrinsic evidence may be used including other written evidence or witness testimony. Contrary to Article 1341, first paragraph of the Civil Code pursuant to which one cannot accept evidence against or supplemental to a contract in writing,[41] any such evidence is admissible in commercial matters.[42] However, statutory rules on evidence are not considered mandatory and, thus, party autonomy applies to the choice of evidence. Case law has accepted that the parties may conclude evidence agreements[43] that in commercial matters may restrict the liberal provisions of the law. Under the law of these jurisdictions, rules on evidence do not significantly modify the substantive law regarding contract interpretation because either the legal rules are very liberal or contractual evidence clauses are deemed valid and enforceable. A similar situation exists in The Netherlands under new rules of evidence introduced in 1988 in the Code of Civil Procedure providing for liberalism and flexibility. The validity of evidence agreements is expressly in these rules regarding rights private parties may prevail upon (Article 153 Code of Civil Procedure).

Other civil law jurisdictions have more restrictive rules on evidence; a position different from French, Belgian and Dutch law positions is found in Italy. There, evidence agreements must be fine-tuned to correspond with substantive contract law, and an agreement excluding some evidence could not prevent judges from looking for the real intention of the parties (Article 1362 Codice Civile). In Germany, there are also liberal rules on evidence for proving contract content, but evidence agreements are only valid in relation to the burden of proof but not regarding means of evidence or

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[41] The French provision provides as follows:

> "Il doit être passé acte devant notaires ou sous signatures privées de toutes choses excédant une somme ou valeur fixée par décret, même pour dépôts volontaires, et il n'est reçu aucune preuve par témoins contre et outre *le* contenu aux actes, ni sur ce qui serait allégué avoir été dit avant, lors ou depuis les actes, encore qu'il s'agisse d'une somme ou valeur moindre."

The Belgian provision has a similar wording.

[42] For Belgium, see X. Dieux, La preuve en droit commercial belge, *Revue de droit commercial belge*, 1986, pp. 85–86 and 93–94.

[43] Cass. November 8, 1989, Bull. Cass. 1989, No. 342, D. 1990, 369; see also J.M. Mousseron, *Technique contractuelle*, 2nd ed., Paris, Francis Lefebvre, 1999, pp. 687–694.

assessment of evidence.[44] Special rules apply to general conditions where protective rules, adopted in the Statute on General Conditions (Section 11 No. 15 AGBG—Gesetz über die Allgemeinen Geschäftsbedingungen) and recodified in 2001 in Section 309(12) BGB, limit the possibilities to have clauses in general conditions reversing or changing the burden of proof. These rules may be applicable in commercial transactions provided German law is used in the contract. Finally, there is Switzerland where the majority opinion holds positions that are similar to those in Germany. Accordingly, evidence agreements reversing the burden of proof are binding based on the non-mandatory character of Article 8 of the Code of Obligations with either party proving the facts on which it relies. Agreements covering means of evidence and the assessment of evidence are considered ineffective since they restrict the freedom of the judiciary to assess the evidence and of the parties to handle the evidence as they wish during the trial. However, one author has proposed to accept the enforceability of evidence agreements regarding the means of evidence since these clauses do not directly interfere with the discretion of judges regarding the assessment.[45]

The common law on evidence is quite different from the law in civil law countries. Rules on evidence are stricter and should be taken into account when analyzing interpretation clauses. The crucial principle is the *parol evidence rule* that—unlike in civil law jurisdictions—excludes some evidence if the contract is in writing. However, the scope of the parol evidence rule differs between common law jurisdictions. In England, the parol evidence rule is more flexible than in the United States. Under English law, the parol evidence rule attempts to provide legal certainty and, thus, excludes oral evidence or other evidence (such as drafts of contracts) establishing that there are other contractual terms than those contained in the written instruments. Under that rule, the parties cannot prove express contract terms that add to, vary or contradict written terms.[46] There are some

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[44] Zöller, *Zivilprozeßordnung*, 20th ed., Cologne, Otto Schmidt Verlag, *No. 32 vor § 128 ZPO, No. 23 vor § 284 ZPO; Baumbach/Lauterbach/Albers/Hartmann Zivilprozeßordnung*, 56th edition, Munich, Beck, *Nos. 6–7 Anh § 286 ZPO;* for a critical view of this opinion rejecting the admissibility of means of evidence agreements, see G. Wagner, *Prozeßverträge*, Tübingen, Mohr, 1998, pp. 685–691.

[45] On all these aspects, see C. Chappuis, Validité d'une "entire agreement clause" en tant que convention de procédure, unpublished report, March 17, 2000, 7 pp. The author cited by Chappuis taking the Swiss minority view is U. Kaufmann, *Freie Beweiswürdigung im Bundesprivatrecht und in ausgewählten Zivilprozessordnungen*, Zürich, 1986, pp. 109–111.

[46] Under Scottish law, the situation is different. Under Section 1 of the Contract (Scotland) Act 1997, the parol evidence rule does not apply so that extrinsic evidence is permissible unless the parties expressly have declared that the contract is the complete expression of their agreement (see H.L. MacQueen, M.A. Hogg, & P. Hood, *Muddling*

exceptions to the rule. For our analysis, the most important exceptions are that a party may still prove that the written contract did not constitute the entire contract between the parties or that a different collateral agreement had been concluded between the parties. Both exceptions make the parol evidence rule much more open-ended and flexible than would appear on first reading. Still, there is a gradual difference with civil law jurisdictions to be taken into consideration when analyzing contract interpretation in a comparative setting. The parol evidence rule does not attempt to exclude evidence that purports to clarify ambiguities. Nor does it prevent the reading of implied terms into the contract since the rule only applies to express terms not recorded in writing.[47]

Because of the intricacies of the parol evidence rule, parties often insert *entire agreement clauses* into their contracts that attempt to establish that the contract in writing expresses their entire agreement and that exclude parol evidence of any additional or contradicting term. These clauses add to the presumption that a written contract is deemed to express the parties' entire agreement and makes that presumption irrefutable. Therefore, the entire agreement clause establishes the contract in writing to be final excluding any additional or contradicting express terms.

The situation in the United States is more complicated than in England. First, the parol evidence rule applies in the United States if the parties adopted a written contract as a final expression of their agreement. If so, prior or contemperaneous terms are deemed to have been completely integrated into the written contract and the parol evidence rule then comes into play to exclude evidence showing that there are other terms (both contradicting or additional terms) than those expressed in the written contract (complete integration). Apart from complete integration, there is also the possibility of partial or incomplete integration if the contract is the final expresssion of only a part of the contract. The parol evidence rule then excludes evidence attempting to establish the existence of contradicting terms but would admit extrinsic evidence of additional terms. In view of the differences regarding the legal effects to be given to complete or partial integration, the key issue is to determine whether one is fac-

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through? Legal Responses to E-Commerce from the Perspective of a Mixed System, Molengrafica, Europees Privaatrecht, Lelystad, Vermande, 1998, p. 218). In England, the Law Commission scrutinized the parol evidence rule in 1986 but concluded that it was not a rule of law to be abrogated since it was but a circular statement excluding evidence if it was proven that the written contract contained all the express terms of the contract (see J. Beatson, *Anson's Law of Contract,* Oxford University Press, 1998, 27th ed., p. 131).

[47] For all these elements, see K. Lewison, *The interpretation of contracts,* London, Sweet & Maxwell, 2nd ed., 1997, pp. 45–50. For all the exceptions to the parol evidence rule, see G.H. Treitel, *The Law of Contract,* London, Sweet & Maxwell, 1999, 10th ed., pp. 175–183.

ing complete or partial integration if the written contract does not say so. Under an older restrictive view proposed by Williston and adopted in the First Restatement of Contracts and still followed by a minority of courts, extrinsic evidence can be admitted only if it appears on its face that the written contract is incomplete and the written contract has omitted a prior term. The written contract is then deemed only to have partially integrated prior terms and additional prior terms may be proven by extrinsic evidence. Under the prevailing and more liberal view of Corbin, endorsed by the Second Restatement of Contracts, by Section 2-202(b) of the Uniform Commercial Code[48] on sales and by the majority of courts, extrinsic evidence may be used to establish prior agreements, and the courts, on the basis of that evidence, will determine whether the parties intended a written contract to be completely or partially integrated. Subsequently, the courts will either exclude extrinsic evidence if the written contract is fully integrated or admit extrinsic evidence to prove additional terms if the written contract is partially integrated.[49]

In order to avoid the complications stemming from the parol evidence rule, the ulterior determination by courts of the complete or partial integration of the contract and the factual determination in this regard during jury trial, contracting parties often insert *integration* or *merger clauses* into their contracts. It seems that the term "entire agreement clauses" has developed more in England, whereas the Americans use the term "integration clauses" or "merger clauses." These clauses provide for complete integration of prior and contemporaneous agreements and thereby attempt to exclude extrinsic evidence of additional and contradicting terms. These clauses will be analyzed below (see Section III.C.3). At this moment, it is sufficient to state that under American law the parol evidence rule excludes evidence of terms contradicting the terms of the written contract, and, depending upon the presence of complete or partial integration, excludes or does not exclude evidence of additional terms. So far, we were dealing with prior agreements (in writing or oral) or contemporeneous oral agreements that depart from the written contract or add terms to it and where the parol evidence rule may prohibit evidence. Now, the question arises whether implied terms imposed by law, by trade usage, by course of dealing or by course of performance are affected by the parol evidence rule.

[48] This provision is currently under revision in the broader context of the revision of Article 2 of the UCC on sales, see in this respect H. Gabriel, How International Is the Sales Law of the United States?, Centro di studi e ricerche di diritto comparato e straniero, Saggi, conferenze e seminari, 34, Rome, 1999, 11–12.

[49] See on all these elements, *Farnsworth on Contracts,* 2nd ed., Aspen Publishers Inc., 1998, II, pp. 215ff.; E.A. Farnsworth, The Interpretation of International Contracts and the Use of Preambles, *I.B.L.J.,* 2002, pp. 272–275 and J. Gordley, An American Perspective on the Unidroit Principles, Centro di studi e richerche di diritto comparato e straniero, Saggi, conferenze e seminari 22, Rome, 1996, pp. 19–24.

Generally, gaps in the contract may be filled by means of these standards, and the parol evidence rule is not applicable to these instances since they supplement the contract by operation of legal principles of contract interpretation and not through party incorporation that would need to be proven. However, courts in the United States are divided over the question whether the parol evidence rule would prohibit extrinsic evidence that the parties agreed to a term other than a term implied by law, trade usage, course of dealing or course of performance.[50] The parol evidence rule does not exclude extrinsic evidence to explain the ambiguity on the basis of prior or contemporaneous agreements.[51]

Uniform law and particularly CISG do not contain specific evidence provisions. In any event, there is no parol evidence rule in CISG, and interpretation problems under this convention will be governed by its abovementioned principles on interpretation. However, there is still the problem how to solve these interpretation problems in litigation in common law jurisdictions that have adopted CISG and where the question arises whether the parol evidence rule applies to any such litigation.[52] Article 2.1.17 of the Unidroit Principles and Article 2:105 PECL have banned the parol evidence rule and allow extrinsic evidence to supplement or even contradict a written contract. However, *merger* clauses may still purport to correct the operation of this rule, and statements or agreements may still be invoked to interpret the writing (see Section III.C.3).

By way of conclusion, one may say that under American law much more than under English law and contrary to European continental systems, rules on evidence to a large extent bear upon contract interpretation, especially as to contradicting and additional agreements but not so regarding the filling of gaps by law or in finding the solution to ambiguities.

III. ANALYSIS OF INTERPRETATION CLAUSES IN INTERNATIONAL CONTRACTS[53]

The empirical analysis of interpretation clauses will be limited to international commercial contracts and deals only with general problems of contract law and obligations regarding interpretation. Special con-

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[50] J. Gordley, *loc. cit.*, pp. 19 and 22–23.

[51] See Second Restatement of Contracts § 214.

[52] See *infra* Section III.C.3.

[53] See M. Anderson, *Drafting and Negotiating Commercial Contracts*, London, Butterworths, 1997, pp. 75–121; J.M. Mousseron, *Technique contractuelle*, 2nd ed., Paris, Francis Lefebvre, 1999, pp. 681–685; A.G.J. Berg, *Drafting Commercial Agreements*, London, Butterworths, 1991, pp. 2, 56–86, 165–169, 171–172; R. Christou, *Boilerplate Practical Clauses*, London, Financial Times Law & Tax, 2nd ed., 1995, pp. 10–31 and 179–187; D. Fosbrook, & A. Laing, *The A-Z of Contract Clauses*, London, Sweet & Maxwell, 1996, p. 519.

tracts, which, under the applicable law, may be affected by special considerations or governed by specific provisions (e.g., specific statutory provisions or special treatment in case law in the interpretation of employment contracts, consumer contracts[54] or insurance contracts), were not included in the analysis.

Interpretation clauses have developed in practice because the laws on interpretation in many jurisdictions are not mandatory. The interpretative rules found in the statutes, primarily in civil law countries based on French law, as well as those developed in the common law are guidelines to help judges and arbitrators in interpreting contracts and generally were not conceived to form a basis for review by supreme courts in the context of procedures of *cassation*.[55] This reluctant attitude by supreme courts to interfere with contract interpretation is often related to their position in the judiciary where they are not trial judges and, therefore, contract interpretation as a fact-determining process is largely left to lower courts. Thus, contract clauses dealing with interpretation issues will, as a matter of principle, be upheld and enforced by courts and arbitrators.

This perspective might differ in an objective contract law theory. An indication is Section 1–102(3) of the American UCC, which provides that the standard of good faith may not be varied by agreement but does not exclude that the parties determine reasonable standards against which to measure the performance of the obligation.[56] Under any such objective perspective, good faith and fair dealing is a higher principle than the autonomy of the parties. Consequently, the parties cannot establish terms that run contrary to good faith and fair dealing. It is, however, unclear whether they might limit the scope of their contractual obligations to those in the written contract and, thus, prevent that judges or arbitrators impose new obligations on the basis of good faith and fair dealing.[57] It has already been emphasized that the objective theory has not yet solved its intrinsic tension between objective standards of adjudication and the parties' intentions.

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[54] E.g., within the European Union, the Council Directive 93/13 of April 5, 1993 regarding unfair contract terms in consumer contracts, OJ L. 95, April 24, 1993, pp. 29–34.

[55] The case law of the French Supreme Court regarding *clauses claires et précises* is an exception to this rule (see *supra*, Section II).

[56] Similar provisions may be found in Article 1.7(2) of the Unidroit Principles of International Commercial Contracts and Article 1:201(2) PECL.

[57] Compare Articles 1.7(2) and 4.8 Unidroit Principles; Articles 1:201(2) and 6:102 PECL.

The ambiguity as to the validity and scope of contractual interpretation clauses in different national legal systems must, of course, have an effect on legal practice. For that reason, notwhithstanding the fact that there is a lot of uniformity regarding some of these clauses because they are often used as *boilerplates,* their legal status may vary from jurisdiction to jurisdiction and, for that reason, local counsel should be involved in cases of doubt or problems.

Interpretation clauses may cover a wide range of different problems and situations in which the parties want to avoid complications arising from misunderstandings, ambiguities, not-recorded terms, contradictions or gaps. For the purposes of this analysis, without attempting to be complete, the following 12 categories of interpretation clauses have been identified based on the research of some 270 interpretation clauses found in international commercial contracts supplied by the members of the Working Group.

A. Characterization Clauses
B. Contract Definition and Ranking Clauses
C. Entire Agreement Clauses
D. Heading Clauses
E. Definition Clauses
F. Language Clauses
G. NOM-Clauses (No Oral Modification Clauses)
H. Non-Waiver Clauses
I. Severabilty Clauses
J. Gap-Filling Clauses
K. Custom, Usages and Course of Dealing
L. Good Faith and Fair Dealing Clauses

A. Characterization Clauses

The first series of interpretation clauses relates to identifications by the parties as to the nature of their contracts. This may be the title of a contract that often is found on the cover page of international contracts. The contract title identifies contracts and is a very useful instrument of contract management for contract managers in sales, purchasing or legal departments of companies. It distinguishes contracts from one another and may enable classifying contracts alphabetically or by subject matter. Characterizations may not only be found in the contract title but also in specific contract clauses characterizing the contract. The following examples may be given:

- "INDEPENDENT CONTRACTOR
  "CONTRACTOR, in performing WORK and its other obligation under CONTRACT, shall be and shall be deemed to be an independent contractor and not the agent or employee of OWNER. OWNER shall not have any authority to supervise CONTRACTOR's

employees, representatives or subcontractors, and WORK shall be performed under the supervision and control of CONTRACTOR. CONTRACTOR shall not have authority to make statements, representations or commitments of any kind or take any other actions which would be binding upon OWNER, except as is now specifically provide in CONTRACT or as may be provided in subsequent documents executed by a duly authorized officer of OWNER."

- "This Agreement does not in any way create the relationship between Licensor and the Licensee of principal and agent, partners or joint ventures and the relationship between the parties is that of independent contractors with each party conducting its business at its own responsibility and expense. Accordingly neither party hereto shall have any authority or power to incur any obligation on behalf of the other party."
- "This Agreement shall not be construed in any way to create any joint venture, partnership, or principal and agent relationship between B and Purchaser, and neither party shall state or imply otherwise to any third party or attempt to pledge the credit of the other party or to contract in the name of, bind or act for the other party."

These clauses have been found under different headings and can be found as a specific contract article or be inserted in other contract clauses (such as in entire agreement clauses, definition clauses or in a miscellaneous clause). Often, they find their place after a description of the rights and obligations of the parties but one may also consider having these clauses at the very beginning of the contract after the recitals.

These contractual characterizations may have management objectives, for instance to serve as instructions to management to avoid that close cooperation ends in the creation of employment contracts, agency contracts or partnerships. They also have legal purposes. By characterizing their contracts, companies may opt for bringing contracts within the classifications of the applicable legal system. This implies that the parties, by their contractual characterization, seem to have intended that statutory rules or case law rules for this class of contracts (e.g., sales) should be applied. Since more classes of contracts are governed by codified rules in civil law countries, characterization and clauses relating thereto seem to be more important in civil law countries. As the examples indicate, the clauses often have two sides. On the one hand, the parties characterize the contracts as they think the contracts should be. On the other hand, they also indicate how the contracts should not be characterized. Characterization clauses, thus, may have both positive and negative functions.[58]

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[58] For a general theory on characterization, see F. Terre, *L'influence de la volonté individuelle sur les qualifications,* Paris, L.G.D.J., 1957, 599 pp.

In this respect, a distinction must be made between dispositive contract rules and mandatory rules. In the latter case, contractual characterizations in international contracts will only have a limited effect if international mandatory rules (*règles d'application immédiate, Eingriffsnormen*) are concerned. Then, the contracting parties will first be bound by mandatory rules (including public policy rules[59]) of the law chosen by the parties or of the law applicable in the absence of any such choice.[60] Second, the parties will be bound by the *règles d'application immédiate* of the court[61] hearing their case to the extent that these rules are applicable to their situation.[62] A contractual characterization, which would, for instance, attempt to characterize an employment contract as a management contract, will be scrutinized as to the question whether the factual circumstances of the case warrant any such qualification. If not, the contract will be disqualified and may be re-characterized by judges or arbitrators as an employment contract. The characterization clause is, therefore, not as binding and final as its first reading might suggest. During the research, only a limited number of such characterization clauses have been identified. The impression is that they certainly occur in practice but that contracting parties generally are aware that these characterizations can be tested in court. Characterization clauses may also be inserted for reasons related to public law. For instance, clauses emphasizing the autonomy of the parties and stating that they cannot act on behalf of one another, may be inserted to avoid that one company is held to have a permanent establishment in the country of the other party.

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[59] This refers to the distinction in France between the *ordre public de protection* and the *ordre public de direction* and to the Belgian distinction between *règles impératives* and *règles d'ordre public* (see G. Baeteman, Les effets des dispositions légales impératives protégeant des intérêts privés, case note under Belgian Supreme Court, December 6, 1956, *R.C.J.B.*, 1960, pp. 164ff). In both cases, a distinction is made between the private interests (e.g., of employees, consumers, tenants) and the public interests (e.g., economic or monetary organization of states, morality) which need protection by a rule of law.

[60] In relation to so-called weaker parties such as employees or consumers, choice of law will be restricted and the conflict rules often will lead to the application of the law of the place where the employee habitually works or—to the extent that consumer protection exists (mostly for passive consumers)—of the place where the consumer has his habitual residence (see for instance Articles 5 and 6 of the Rome Convention on the law applicable to contractual obligations, OJ L. 266, October 9, 1980, pp. 1–19).

[61] Apart from the application of the local court's international mandatory rules, one should note that sometimes local courts apply foreign international mandatory rules (e.g., under Article VIII(2)b) of the IMF-Treaty or under a *comitas* principle). In the European Union, the possibility to apply foreign mandatory rules has been provided for in Article 7(1) of the 1980 Rome Convention on the law applicable to contractual obligations. However, Germany, Ireland, Luxemburg and the United Kingdom have used the reservation of Article 22 of the Convention to opt out of Article 7(1).

[62] In international commercial arbitration, it is unclear whether and to what extent arbitrators should apply these international mandatory rules. An analysis of this issue falls outside the scope of this chapter.

Where no mandatory rules are involved, differences of opinions exist as to the question whether a characterization by the parties in a contract is binding upon judges or arbitrators. In France, this debate is influenced by Article 12, paragraphs 1 and 3 of the Nouveau Code de Procédure Civile (NCPC), which read as follows:

> "Le juge tranche le litige conformément aux règles de droit qui lui sont applicables. Il doit donner ou restituer leur exacte qualification aux faits et actes litigieux sans s'arrêter à la dénomination que les parties en auraient proposée.
>
> . . .
>
> "Toutefois, il ne peut changer la dénomination ou le fondement juridique lorsque les parties, en vertu d'un accord exprès et pour les droits dont elles ont la libre disposition, l'ont lié par les qualifications et points de droit auxquelles elles entendent limiter le débat."

Some scholars have interpreted these provisions as substantive and thus conclude that a judge is bound by contractual characterizations. A clear majority position, however, has stated that Article 12 NCPC is merely a procedural provision, which implies that a judge is only bound by express characterizations made by the parties during the trial or by contractual characterizations that are not challenged by either party during the trial.[63]

Characterization regarding dispositive rules may be relevant for mixed contracts that have elements of two different kinds of contracts such as sales and license or sales and construction. Since the rules regarding these contracts may be different (for instance regarding liability), a proper characterization of the contract by means of a contract clause may be important. However, the general feeling during the discussions at the meetings of the Working Group was that a contractual characterization is not decisive and binding if it does not correspond to the essential elements of the contract under which the clause is subsuming the contract. Thus, the final characterization of the contract remains the task of judges and arbitrators.

In contract practice, drafters do not pay sufficient attention to clarify the purposes of their contractual characterizations nor to the above-mentioned important distinction between characterizations relating to mandatory rules and those relating to dispositive rules. It is recommended to specify the tax, social security, labor law or economic regulatory reasons

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[63] For a discussion and arguments for the latter position, see A. Laude, *La reconnaissance par le juge de l'existence d'un contrat,* Aix-en-Provence, Presses Universitaires, 1992, pp. 418–419. For a general discussion, see B. Fauvarque-Cosson, *Libre disponibilité des droits et conflits de lois,* Paris, L.G.D.J., 1996, pp. 64–68.

inspiring characterization clauses as well as any other reasons that the parties may have to insert any such clauses in their contracts.

B. The Process of Contract Determination

Once the contract has been characterized in its title and, if need be, in a specific characterization clause, the parties often consider determining the precise scope of their contractual obligations by referring to those documents containing their obligations. These documents can be manifold: a master contract, implementing contracts, ancillary contracts, general conditions, pre-contractual documents (such as drafts or letters of intent), annexes, schedules, price lists, drawings or technical specifications. Thus, contracting parties may determine the relationship and priority between these documents and eventually to exclude some of these documents.

Unfortunately, these different elements combined are seldom in contract practice. The research indicates that there are scant contract clauses, which at the same time provide for a determination of (1) the contract documents; (2) the hierarchy of these documents; and (3) those documents and other evidence that the parties want to exclude from the scope of their contracts. A rare example of any such clause is the following:

> "Article 14. Documents Constituting this Agreement
>
> "The documents constituting an integral part of this Agreement and the priority of their interpretation in the event of contradiction between these documents, are set out below:
>
> "1. The provisions of this Agreement.
>
> "2. The Annexes to this Agreement to be mutually agreed upon by the parties whenever need arises during the course of this Agreement. These Annexes may be agreed upon by the parties by an exchange of letters or telefax-messages, signed by both parties.
>
> "3. Any correspondence signed by both parties hereto concerning mutually agreed changes, amendments or interpretations of this Agreement.
>
> "Article 15. Entire Agreement
>
> "Terms and conditions set forth in the Agreement and the Annexes constitute the entire Agreement between both parties and shall supersede any prior commitments, representation, agreements and/or understanding either written or verbal between both parties in respect of said matter."

This clause may be used as an example for the analysis below. It indicates that parties first should define the contractual documents (1), then

the hierarchy of the various documents (2), and finally, whether and to what extent other documents or evidence is to be excluded from the scope of their contracts (3).

1. Contract Definition Clauses

Some contract clauses define the documents in which the contractual rights and obligations of the parties are contained.[64] These clauses were found, *inter alia*, in the construction industry for large scale projects but also in the services sector for long-term support and maintenance contracts. Some examples:

- "1.1.7 The Joint Venture Agreement, hereinafter referred to as "this Agreement," comprises the document entitled Conditions and Terms together with Schedules 1 to 4 attached there to and such other documents as may be specified in Schedule 1 to form part of this Agreement;"[65]
- "This agreement shall mean this present document and all annexes, exhibits and other documents referred to herein or attached hereto and signed or initialled by the parties hereto all of which annexes, exhibits and other documents form an integral part hereof."

Sometimes, these clauses only refer to annexes or exhibits that through the operation of these clauses, are incorporated into the contract as the following examples show:

- "Annexes
  "Les Annexes à la présente Convention en font partie intégrante."
- "Exhibits. All Exhibits to this Agreement are hereby incorporated by reference as though fully set forth herein."

For reasons of precision and because annexes are usually numbered, clauses sometimes specifically refer to the numbered annexes:

"10.12. Annexes. The aforementioned Annexes No. 1 to No. 12."

2. Ranking Clauses

The contractual documents being defined, contract clauses sometimes provide for the ranking of these various documents.[66] This ranking is par-

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[64] These clauses are inserted at the beginning of the contract in a specific clause, in the definition clause of the contract or in an entire agreement clause at the end of the contract.

[65] FIDIC's Joint Venture (Consortium) Agreement, in Guide to the Use of FIDIC's Sub-Consultancy and Joint Venture (Consortium) Agreements, FIDIC, Lausanne, 1994, Appendix B, 10.

[66] These clauses are found in a specific clause at the beginning of the contract

ticularly relevant to avoid contradiction between the numerous contract documents[67] and determines the priority order of the contractual documents. Some examples may be cited:

- "1.3 Conflicting Provisions
  "In the event of any conflict between this CONTRACT and any of the Attachments hereto, the terms and provisions of this CONTRACT shall control. In the event of any conflict among the Attachments, the Attachment of the latest date shall control."
- "13.2. In the event of any conflict or inconsistency among the provisions referred to in the preceding paragraph the order of priority shall be the order in which such provisions are listed."
- "2 (iii) If there is conflict between provisions of the Agreement, the last to be written chronologically shall prevail, unless otherwise specified in Part II."[68]

In order for any such clause to become operational, one must first determine whether there is a conflict between the contract documents. The above-mentioned clauses do not address this issue and may have the disadvantage of operating too automatically or, in practice, to be inoperative. However, some clauses in this respect impose a contextual interpretation. The contract clauses are to be read in combination with one another in order to determine whether there is a conflict. Ranking clauses are to be applied only if context cannot provide an answer to the interpretation problem. The following clauses are examples of any such clauses:

- "Should there be any conflict, discrepancy, inconsistency or ambiguity between any documents of the Contract, then, unless otherwise expressly provided, the provisions of the Contract shall prevail on the provisions of the Exhibits, . . ."
- "Subject to the foregoing, the Contract Documents are intended to be correlative and mutually explanatory."
- "Any specific obligation incumbent upon a Party or the Parties pursuant to the provisions of the Schedules shall be read and interpreted in conjunction with the terms hereof. In case of ambiguity,

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together with a contract definition clause, in the definition part of the contract or in the entire agreement clause at the end of the contract. Their headings are labeled *conflicting provisions, priority of documents, rank of documents* or the like.

[67] See M.H. Maleville, *op. cit.*, p. 30.

[68] Clause 2(iii) of the Client/Consultant Model Services Agreement—The White Book, FIDIC, Lausanne, 2nd ed., 1991. One may wonder how one could possibly determine the chronology of writing of contract clauses. Maybe the clause refers to the order of the contract clauses under which, for instance, Article 28 would prevail over Article 27. But this approach seems to be arbitrary because it is unrelated to the substance of the clause.

inconsistency or incompatibility between any provision hereof and any provision contained in these Schedules, the provision of this Agreement shall prevail over the Schedules."

These clauses may still be too generic and provide insufficient flexibility. One may thus occasionally find extensive contract language to provide for exceptions to the operation of these clauses and to determine a procedure to modify the contract. These clauses were found in the construction industry where variation orders are generally used to modify the contract where a ranking clause would prove to cause difficulties to one of the parties. In those cases, a third party (engineer) is involved in the variation process.[69] The following clause refers to such a contract modification process:

"Should there be any conflict, discrepancy, inconsistency or ambiguity between any documents of the CONTRACT, then, unless otherwise expressly provided, they shall rank in the order of priority listed in sub-Article 1.1., subject however to the provisions of sub-Article 2.10 herebelow."

Ranking clauses may establish the relationship between the contract in which they are contained and other contracts. For instance,

"In case of conflict between this Agreement and the Joint Operating Agreement, this Agreement shall prevail as between the Parties."

or in relation to a sub-contract and a main contract:

"In case of conflict between the appended clauses of the Main Agreement and the other clauses of this Agreement, the documents shall rule in the order prescribed herein, or, if no order is prescribed, the appended clauses of the Main Agreement shall have precedence."[70]

If the related contract has an identical clause, there hardly can be any discussion as to which contract should prevail. If not, any such clause can be deemed to be incorporated into the other contract provided the contracting parties are parties to both contracts. However, other parties can, in principle, not be bound by such a clause.

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[69] The situation is similar to the intervention of an expert or arbitrator in circumstances causing hardship to one of the parties, see, in this respect, Chapter 9.

[70] Clause 2.3.3 of the Sub-Consultancy Agreement, in Guide to the Use of FIDIC's Sub-Consultancy and Joint Venture (Consortium) Agreements, FIDIC, Lausanne, 1994, Appendix A, 10.

3. *Contract Definition and Ranking Clauses*

Elements of contract definition and ranking can also be combined. This approach is taken by some of the FIDIC contracts.

> "Definitions 1.1(b)(i) "Contract" means the Conditions (Part I and II), the Specification, the Drawings, The Bill of Quantities, The Tender, the Letter of Acceptance, the Contract Agreement (if completed) and such further documents as may be expressely incorporated in the Letter of Acceptance or Contract Agreement (if completed)."
>
> "Priority of Contract Documents 5.2 The several documents forming the Contract are to be taken as mutually explanatory of one another, but in case of ambiguities or discrepancies the same shall be explained and adjusted by the Engineer who shall thereupon issue to the Contractor instructions thereon and in such event, unless otherwise provided in the Contract, the priority of the documents forming the Contract shall be as follows:
>
> (1) The Contract Agreement (if completed);
> (2) The Letter of Acceptance;
> (3) The Tender;
> (4) Part II of these Conditions;
> (5) Part I of these Conditions; and
> (6) Any other document forming part of the Contract."[71]

C. Entire Agreement Clauses[72]

Having defined the contract documents and their ranking, the parties often provide for clauses that freeze the contract as it is in its written form. These clauses are hereafter referred to as *entire agreement clauses* (*intégralité des conventions, accord complet, Vollständigkeitsklauseln*). This terminology is often used in the headings of these clauses but other headings (e.g., previous agreements, former agreements, entire contract, whole agreement,

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[71] Conditions of Contract for Works of Civil Engineering Construction—The Red Book, FIDIC, Lausanne, 4th ed., 1989. Similar provisions may be read in clauses 1.11.3 and 5.3–5.4 of the Conditions of Contract for Electrical and Mechanical Works—The Yellow Book, FIDIC, Lausanne, 3rd ed., 1988, in clauses 1.1.1.1 and 1.6 of the Conditions of Contract for Design—Build and Turnkey—The Orange Book, FIDIC, Lausanne, 1st ed., 1995 and in clauses 1.1(b)(ii) and 3.4 of the Conditions of Subcontract for Works of Civil Engineering Construction, FIDIC, Lausanne, 1994, 1st ed.; *compare* clause 2(iii) of the Client/Consultant Model Services Agreement—The White Book, FIDIC, Lausanne, 2nd ed., 1991.

[72] See H. Dubout, *Les clauses d'entire agreement (accord complet) dans les contrats internationaux: intérêt et précautions d'utilisation,* Cahiers juridiques et fiscaux de l'exportation, C.F.C.E., 1989, No. 1, pp. 193–209.

complete agreement) sometimes are also used. The terms *four corner clauses*[73] or the U.S. terms *merger clauses or integration clauses*, however, have hardly been found in the contract clauses that were the subject of the research.

As will be seen below (see Section C.3), the American terms of merger or integration clauses reflect the function of these clauses better. Because in England and in civil law jurisdictions the terms of entire agreement clause is traditionally used, this concept will be used hereafter. It is suggested that the term four corner clause is to be rejected because it is misleading and confusing as to the function of these clauses (see Section III.C.3).

Simple examples of entire agreement clauses may read as follows:

- "11.1 This contract, including all the schedules attached hereto which represent an integral part hereof and have been signed by the parties, constitutes the entire agreement between the parties."
- "Ce contrat contenant l'intégralité de l'accord intervenu entre les parties ne peut être modifié que par écrit dûment signé par chacune des parties."

In only one case did the entire agreement clause provide that the context might indicate that the clause could not automatically be enforced:

> "Entire Agreement. Unless the context otherwise requires, this Agreement (including its Exhibits) represents the entire agreement existing between the parties relative to the subject matter hereof."

These clauses in their simplicity are extremely difficult to interpret because they do not draw any conclusions from their *entire agreement* language. Thus, it is recommended not to use such vague clauses. In its analyses, the Working Group did find different functions that may be attributed to entire agreement clauses:[74]

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[73] The terminology is used in Belgium as a result of its use in two books: D. Deschoolmeester, & G. Vandenberghe, *De keuze van een computer*, pp. 142–143 and H. Gevaert, *Juridische preventie bij computercontracten*, Brugge, die Keure, 1983, pp. 7–9 (translated as *La prévention juridique des contrats informatiques*, Bruges, la Charte).

[74] Other exclusionary functions may also be envisaged. For instance, the following clause is cited by Dubout (*op. cit.*, pp. 202–203):

> "Cependant les obligations des parties ne seront pas limitées à celles énumérées dans le contrat quand la loi impose d'autres obligations, étant toutefois entendu que le contrat prévaudra sur toute loi avec laquelle il est en contradiction ou qu'il exclut expressément pour autant que cela soit juridiquement possible."

For a discussion of this clause, see H. Dubout, *loc. cit.*, pp. 202–208. Similar clauses have not been encountered during the research project and, therefore, such clauses

1. Exclusion of simulation (side letters, *contre-lettres*);
2. Exclusion of previous contracts;
3. Exclusion of pre-contractual documents;
4. Exclusion of written or oral representations;
5. Exclusion of general conditions;
6. Exclusion of future contracts.

From the outset, one may note that most entire agreement clauses do not address all these functions. In this respect, it is recommended that contract drafters keep these different functions in mind and clearly spell out which of these objectives are to be met by the clause.

Before embarking on further analysis, one preliminary point needs to be noted. Entire agreement clauses have their origin in Anglo-American law where they serve exclusionary objectives and, thus, may exclude extrinsic evidence but only in relation to terms on which the parties may have agreed and that may contradict the agreement in writing or that prove that the parties have agreed on additional terms not reflected in the written agreement. However, they do not impose strict or literal interpretation nor *intro-interpretation* in order to deal with ambiguities and gaps of the contract nor do they necessarily address variations agreed upon by the parties once the contract has been concluded. The key issue regarding these clauses is whether they are to be applied in conformity with their historical origin when they are used in a civil law context or whether they need to be adapted and interpreted in any such perspective. From a practical point of view, these issues may be avoided by not importing these clauses *ne varietur* in a civil law context but to re-draft them in order to clarify these clauses and to adapt their Anglo-American objectives to the civil law.

1. *Exclusion of Simulation (Side-Letters or Contre-Lettres)*

Simulation occurs where the written contract document does not coincide with the common intentions of the parties because the parties have made a side contract (*contre lettres*) deviating from the main written contract. This can, for instance, be inspired by tax reasons to state in the written deed a lower purchase price for a real property transaction than what the parties actually have agreed to pay in order to reduce tax liabilities for income or registration taxes. But there may also be legitimate reasons to draft a side-letter if, for instance, confidential information is disclosed and the contract needs to be submitted to government institutions for approval or to banks or insurance companies to obtain finance or credit insurance.

have not been included in the classification. The clause cited above intends to liberate the contract to the largest extent possible from dispositive rules of the governing law. It is a matter of discussion whether and to what extent such a clause in an international contract may be characterized as a choice of law provision which detaches the contract from any national governing law and whether the contract is then subject to *lex mercatoria* or similar concepts. This debate falls outside the scope of this chapter.

Article 1321 of the French and Belgian Civil Codes provide that these side-letters only bind the parties thereto[75] and cannot be invoked against third parties.

An entire agreement clause may exclude the application of the theory of simulation. However, this problem was identified and discussed only during one meeting of the Working Group, but no contract clauses have been found reflecting this problem or the intention of the parties to exclude the theory of simulation. It is submitted that this will occur infrequently in practice,[76] and that the parties, if they intend to use side-letters, should not use an over-comprehensive entire agreement clause or, in case of a dispute, object to giving an entire agreement clause such an extensive reading that it would also cover excluding simulation.

2. *Exclusion of Previous Contracts*

A second function, which entire agreement clauses may have, is to exclude previous contracts, which are still in force, from the scope of the parties' contractual obligations. These clauses intend to avoid the co-existence of different contracts. The following clauses are examples:

- "This Agreement specifically supersedes the joint venture agreement between Seller and Purchaser. This joint venture agreement will consequently be terminated."
- "The Distribution Agreement and the Letter Agreement (except for those provisions setting forth the terms of the Warrants) are hereby terminated."

These clauses are part of more broadly formulated entire agreement clauses in two contracts. In both cases, an older contract came to an end and a new contract was concluded between the same parties. Thus, the contract drafters of these contracts intended the new contracts to reflect all of the parties' rights and liabilities and, consequently, in their entire agreement clause excluded the older contracts by providing that these have or will be terminated. It remains, however, unclear what the consequences are of any such termination, for instance, if and to what extent there may still be obligations under these contracts.

It is unclear if the same conclusion can also be reached in the absence of any such *sunset* clause. Much will depend upon the wording of the entire agreement clause. If it is a boilerplate clause, which only provides that the written document constitutes the entire agreement between the parties,

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[75] See also Article 6:103 PECL. The Unidroit Principles do not seem to have a provision regarding simulation.

[76] In literature, the problem is also mentioned in A.G.J. Berg, *op. cit.*, p. 172.

one may doubt, on the basis of that provision alone, whether the correct interpretation under both the subjective and objective theories is that the older contract was terminated by the entire agreement clause.[77] Under both theories, one will—based upon a search for the common intention of the parties or an assessment as to what is reasonable under the circumstances—conclude whether the old contract was terminated. The more specific the clause is, the more likely the conclusion will be that a new contract has replaced the previous contract. Also, the survival clause of the previous contract may be relevant in assessing the situation.[78]

The position may be somewhat different under English law because of the tradition of literal interpretation where judges will give more weight to the precise drafting of the entire agreement clause. It is recommended to specifically include the case of previous agreements regarding the same subject matter in broadly phrased entire agreement clauses or to add this circumstance to contract drafting checklists. On the other hand, one should also warn against the automatic effect of an overly detailed entire agreement clause, as the following clause of the ICC Model Agency and Distributorship Contracts[79] illustrates:

> "Article 26 Previous agreements—Modifications—Nullity
> 26.1. This contract replaces any other preceding agreement between the parties on the subject."

> "Article 26 Previous agreements—Modifications—Nullity—Assignment
> 26.1. This contract replaces any other preceding agreement between the parties on the subject."

Since agency and distribution contracts may first be concluded orally or for fixed-term periods, one should carefully review whether the clauses set forth above correspond with the intentions of the parties to exclude all previous arrangements that may have been agreed upon orally, by exchange of correspondence, by riders to contracts and the like. Depending on the

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[77] In a New York case, it was held by the New York Court of Appeals that, absent contrary intent, a boilerplate entire agreement clause is not to be interpreted to exclude the application of arbitration clauses in two previously concluded contracts. Thus, court proceedings regarding these two contracts were stayed and the parties were referred to arbitration notwithstanding the fact that the later agreement containing the entire agreement clause had no arbitration clause. The arbitration clauses of the two previous contracts were deemed to have survived the termination of these contracts and not to have been excluded by the entire agreement clause (*Primex International Corp. v. Wal-Mart Stores Inc.*, 679 N.E.2d 624 (N.Y. 1997)).

[78] On survival clauses, see *infra*, Chapter 13.

[79] Article 26(1) of the ICC Model Commercial Agency Contract, ICC Publication No. 644, Paris, ICC Publishing, 2002; Article 26(1) of the ICC Model Distributorship Contract, ICC Publication No. 646, Paris, ICC Publishing, 2002.

industry and the transactions involved, one may consider using either a very broadly formulated clause[80] or a clause that specifically refers to older contracts that have or are to be terminated. In the latter case, one needs to address the question whether the clause is aimed at only dealing with the issue of the relationship between the contract and previous contracts or whether the clause also aims at other objectives.

3. Exclusion of Pre-Contractual Documents

The third function of entire agreement clauses is probably the function that is best known in international contracts and that raises difficult problems, particularly from the perspective of civil law jurisdictions. It occurs with complex transactions where long negotiations and/or intensive drafting is required. These transactions often imply the use of letters of intent, memoranda of understanding (MoU), heads of agreement, exchanges of correspondence and information, minutes of meetings and different drafts and pre-contractual arrangements.[81] Also, some oral arrangements sometimes have been made at the contract preparation stage.[82] All this may happen prior to the signing of the contract; oral arrangements can also be made at the time of contract signature.[83]

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[80] For an example of such a clause written for groups of companies with a parent company and subsidiaries where the possibility has been provided to deviate in writing from the automatic application of the clause:

> "Entire agreement.
>
> Save as otherwise agreed in writing between the Principals or any members of their respective groups, this Agreement and the other Principal Agreements supersedes any previous agreement between the parties and other members of each Principal's Group (including their respective employees, agents and advisers) in relation to the matters dealt with herein and represents the entire understanding between the parties in relation thereto."

[81] During its discussions, the Working Group also addressed the specific issue of the relevance of entire agreement clauses in notification documents filed with the European Commission in Brussels regarding merger control. The notification may have relevance for actions in relation to liability for precontractual liability or for interpretation purposes. There was more doubt whether agreed terms reported in the notification but not recorderd in the agreement between the parties are to be excluded by operation of an entire agreement clause.

[82] For a clause where this situation was specifically covered, see

> "Mündliche Nebenabsprachen zu diesem Vertrag bestehen nicht. Aenderungen der Vereinbarung einschliesslich der ihm beigefügten Anlagen bedürfen zu ihrer Wirksamkeit der Schriftform."

[83] A different problem with references to contract negotiations in recitals may arise with regard to the entire agreement clause of the same contract, see H. Dubout, L'interprétation des contrats internationaux et la pratique des préambules, report presented at the 25th anniversary conference of the Groupe de Travail, Paris, March 2, 2001 (unpublished).

The issue that arises is whether all these written extra- or pre-contractual documents and other evidence regarding the gradual formation of the contract may be used. These clauses are problematic in common law jurisdictions because they tend to exclude the *parol evidence rule,* which implies that they intend to exclude evidence other than the written agreement to prove the terms on which the parties agreed and which contradict or add to the agreement in writing. The common law origin of these clauses generally is not properly understood in civil law jurisdictions. Hence, these clauses in the latter jurisdictions may—incorrectly—be understood to serve purposes such as not to fill gaps, to exclude variations or to exclude evidence other than the contract in writing to solve ambiguities in contract terms.[84]

Another reason for the miscommunication as to the meaning of entire agreement clauses is probably related to their headings and language. Wording such as *entire agreement* (*accord complet*) for lawyers from civil law jurisdictions may suggest that extrinsic evidence may neither be used to prove contradicting or supplemental terms agreed upon between the parties nor to fill gaps, vary contract terms or solve ambiguities. American terminology in merger or integration clauses reflects more clearly the purposes served by these clauses in common law jurisdictions.

The risk of broad reading of entire agreement clauses in civil law jurisdictions does not seem to be warranted by their initial meaning in the common law. For the purpose of this analysis, the historical origin of entire agreement clauses is taken into account and these clauses are analyzed hereafter according to whether evidence other than the contract in writing may be excluded to establish contract terms agreed upon by the parties, but not reflected in the written contract, which either contradict the agreement in writing or add terms to it.

Entire agreement clauses attempt to exclude all that evidence. Just a few examples:

- "La présente Convention à compter de sa signature représente la totalité de l'accord des parties et par conséquent annule et remplace tous documents antérieurs qui auraient pu être échangés ou communiqués dans le cadre de la préparation et de la négociation de la présente Convention."
- "Intégralité des conventions
  Le présent Contrat ainsi que ses annexes qui en font partie intégrante, constitue l'intégralité des engagements entre les Parties et

[84] H. Dubout, *loc. cit.*, pp. 197–200; compare E. Rawach, *La portée des clauses tendant à exclure le rôle des documents précontractuels dans l'interprétation du contrat,* Dall. 2001, pp. 223–226.

établit l'ensemble de leurs droits et obligations et il annule tous les autres engagements verbaux ou écrits antérieurs que les Parties auraient pu souscrire quant à son objet."

- "Entire Contract. This contract contains the final and entire agreement between Seller and Buyer and any prior or contemporaneous understandings or agreements, oral or written, are merged herein."
- "Whole Agreement and Variation. This Agreement (including all documents to be executed pursuant to Clause 4) and the Disclosure Letter contain the whole agreement between the parties relating to the subject matter of this Agreement and no variation of this Agreement shall be effective unless in writing and signed by or on behalf of each of the parties."
- "Entire Agreement; Modification
This Agreement and any Exhibits hereto constitute the entire Agreement between the parties concerning the subject matter hereof. It supersedes any proposal or prior agreement, oral or written, and any other communication and may only be modified in a writing signed by both parties."
- "La présente convention annule et remplace tous les conventions, arrangements, promesses ou accords précédents, y compris les lettres d'intention, qui porteraient sur la présente garantie, ou les éléments qui y sont mentionnés."

As the examples cited above indicate, these kinds of entire agreement clauses are often very broadly phrased and do hardly provide for exceptions. Contract drafters may, however, consider whether some qualifications are not in order in specific situations. One example may be quoted where the clause provides for an exception to a confidentiality agreement that apparently was signed at the contract negotiations stage:

> "It is also however understood that the Proprietary Information and Non Disclosure Agreement between the Parties remain in full force and effect according to its terms and conditions with respect to all the information exchanged between the Parties within the scope defined in such Proprietary Information and Non Disclosure Agreement prior to or independently of this Agreement."

One additional clause has been found during the research where the parties waived their rights to sue on the basis of pre-contractual liability:[85]

> "Except in the case of fraud, no party shall have any right of action against any other party to this Agreement arising out of or in connection with any pre-contractual statement."

[85] See also Chapter 1.

This clause may not be as clear as one might expect, but it shows that the parties might insert express waiver clauses as to pre-contractual liability. As a matter of principle, these waiver clauses should be held valid and effective because commercial parties must be considered to be capable of disposing of their rights by means of a waiver including a pre-contract waiver.

On the other hand, this clause points to the fact that in the absence of such a clause, the entire agreement clause does not purport to exempt from liability in case of negligence during negotiations.[86] In practice, this implies that pre-contractual documents should carefully be stored to safeguard litigation positions to liability proceedings stemming from pre-contractual conduct as for instance in case of a break-off of negotiations.

During its meetings, the Working Group extensively discussed the merits and drawbacks of the typical entire agreement clauses. These clauses have the advantage that the massive documentation produced in the pre-contractual period can be excluded from the scope of the contract. The pre-contractual period, in many cases, will not give conclusive answers to resolve the issues whether the parties were in agreement about terms that supplement or even contradict the terms of the final written contract. Many documents probably will just confirm the contradictions and disagreements between the parties during the negotiations whether some terms were to be included in the final contract. Furthermore, the clause may avoid expensive litigation requiring extensive fact finding. On the other hand, the clause might prevent the parties, judges and arbitrators from finding important and sometimes conclusive evidence as to whether the parties had agreed on a term and, thus, might impair substantive justice. Based on these considerations, there were mixed feelings among the members of the Working Group about the final assessment of these clauses. In the end and on balance, lawyers from civil law jurisdictions were somewhat reluctant to endorse the use of these clauses fully and argued in favor of using these clauses with restraint and with qualifications.

However, in view of the frequency and importance of these clauses, one may question whether the analysis should not be pushed further. In order to determine the nature and the scope of these entire agreement clauses, one should refer to the countries where these clauses originate. Because of their Anglo-American origin, where these clauses have existed for at least 30 years,[87] lawyers from common law jurisdictions and for contracts under

[86] Ph. Marchandise, La libre négociation, Droits et obligations des négociateurs, in *Le juriste dans la négociation, Le droit des affaires en evolution*, Volume 9, Association belge des juristes d'entreprise, Brussels, Bruylant, 1998, p. 19.

[87] In a series of contracts drafted since 1973 by a leading London law firm for a British company, these clauses were already used.

the law of a common law jurisdiction generally would endorse the use of these clauses. Under the laws of civil law countries, there is, however, some doubt as to the legal status and enforceability. One of the major problems is to reconcile the foreign origin of these clauses with the basic assumptions and principles of contract interpretation of civil law countries. The distinction, however, is not so much between common and civil law countries but much more between the subjective and objective theories regarding interpretation where French law is the theoretical archetype of the subjective model, whereas Germany is of the objective models. It was noted that the United States has features of the German model, whereas English law has a somewhat isolated position because of its insistence on literal interpretation. For that reason, the issue exists more between the English model applicable in many common law countries but not in the United States, and the other countries. To that, one should add that French law, in its practical application, is closer to the other countries than to the English model.

On that basis, one could argue that these entire agreement clauses will generally be upheld and enforced by English courts and under English law as well as by English-style jurisdictions. However, with regard to other jurisdictions, there is doubt as to the legal status of these clauses and some authors, under the objective theory, doubt whether the parties may exclude judicial intervention to interpret contracts.[88] The basic argument under the objective theory is that good faith and fair dealing is a principle of a higher ranking than party autonomy and that, therefore, entire agreement clauses may still be reviewed by courts on the basis of their compatibility with good faith and fair dealing. As such, the entire agreement clause would not be invalid but can be reviewed if it amounts to an abuse of contractual rights by one of the parties (the *Schrankenfunktion* of *Treu und Glauben* under German law or the derogatory effect of good faith and fair dealing under Dutch law). However, if the clause only attempts to exclude terms on which the parties have agreed and which add to or contradict the terms of the agreement in writing, it does not seem to conflict as such with good faith and fair dealing and amounts to an express waiver by a party (*renonciation anticipée*).

Under French and Belgian law with their greater sympathy for party autonomy, this category of entire agreement clauses generally will be enforced as validly formed contract terms under Article 1134 Code Civil, but abuses of contract rights will not be protected. On the other hand,

[88] See, for instance, E.H. Hondius, De 'entire agreement' clausule: Amerikaanse contractsbedingen in het Nederlandse recht, in *Recht als norm en aspiratie*, Nijmegen, 1986, pp. 24–34; *contra* R.P.J.L. Tjittes, De parol evidence rule, in Koop, *BW-krant jaarboek 14*, Deventer, Gouda Quint, 1998, p. 45; R.P.J.L. Tjittes, *De betekenis van de parol evidence rule in het Amerikaanse contractenrecht*, Contracteren, 2002, pp. 4–12.

judges in these countries will be interested to know whether the entire agreement clause corresponds to the common intention of the parties. If evidence is produced—in contravention of the entire agreement clause—showing the real intentions of the parties, courts may be inclined to enforce these real intentions and forego the entire agreement clause subject, in France, to the application of the theory of *clauses claires et précises* if the entire agreement clause is crystal clear as to the exclusion of pre-contractual documents. However, if an entire agreement clause can be construed as an express waiver to invoke additional or contradicting terms, it would again be difficult to forego the clause.[89] The dogmatic foundation for bypassing the entire agreement clause[90] could then be found in its boilerplate nature ("clause de style"), which implies that there is no real agreement between the parties regarding this clause causing the final written term to be preempted by another term proving that there was party agreeement. However, the question arises whether this technique of protection against standard contract terms may be used in tailor-made contracts. A second technique could be to argue that the entire agreement clause constitutes a refutable presumption where evidence to the contrary may be brought. One wonders whether this characterization fits well with the common law origin of these clauses. This also implies that the entire agreement clause is characterized as a procedural clause relating to evidence, and the question arises then whether entire agreement clauses may be construed in accordance with any such characterization. The answer is probably negative. Thus, these clauses, from a substantive point of view, seem to be valid and enforceable under French and Belgian law subject to the general reservation of abuse of rights.

As to the civil law position regarding the effects of entire agreement clauses, the hesitations were probably most convincingly expressed during the discussions within the Working Group in the formulation of the argument that common sense would dictate that judges and arbitrators first are to admit the evidence and then to reject it if proven to be unconvincing rather than to declare it inadmissible from the outset.

One other aspect of these clauses is their role in civil litigation. Two interpretations are possible. First, one may interpret these entire agreement clauses as substantive clauses, for instance, as anticipatory waivers. If so, the analysis set forth in the preceding paragraph applies. But one might also characterize these clauses as procedural evidence clauses . One such clause has been found in the research:

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[89] In this sense, Arbitral Award ICC, Case 9117, 10 *Bull. Cour. Int. Arb.* ICC, 1999, No. 2, p. 96 (on the basis of Russian law, CISG and Article 2.1.17 Unidroit Principles).

[90] The discussion of methods to circumvent entire agreement clauses is based on a letter by Professor Christine Chappuis to one of the authors dated June 11, 1999.

> "Terms included herein may not be contradicted by evidence of any prior oral or written agreement or of a contemporaneous oral or written agreement, except as set forth in the preceding paragraph."

Under such a characterization, contracting parties may conclude *evidence agreements*[91] covering the means of evidence, the burden of proof and the assessment of evidence. In international contracts, these problems are generally solved through application of the law of the judge deciding the case (the *lex fori*), the law applicable to the contract (the *lex causae*) or the law where the contract is concluded, where the parties are or where an agent acts.[92] If evidence agreements are permitted under any of these laws, the entire agreement might remain unchallengeable. As has been noted in Section II, such clauses seem to be enforceable under French, Belgian and Dutch law. Under German and Swiss law, these clauses may reverse the burden of proof but could not relate to means of evidence or the assessment of evidence. In Germany, Section 11 No. 15 of the Statute on General Conditions (now Section 309(12) BGB) implies that entire agreement clauses used in general conditions cannot prevent the party against whom the clause is invoked from establishing evidence that there are terms other than the written ones between the parties.[93] This provision is to be characterized as substantive (and not procedural) since it refers to substantive review of general conditions and thus, it is applicable in international contracts if the governing law is German. Finally, contrary to the EU Directive on unfair contract terms, it not only applies in consumer transactions but also between merchants, and only if the governing law is German law.

The procedural characterization of entire agreement clauses is corraborated by their Anglo-American origin. As to the *parol evidence rule*, entire agreement clauses purport to exclude extrinsic evidence to establish contract terms that contradict or add to written terms, but generally do not intend to affect the meaning to be given to contract terms where these terms are ambiguous, or to rule on the filling of contractual gaps. Under English law, entire agreement clauses are aimed to protect against arguments that the written agreement does not constitute the entire agreement between the parties or against findings in litigation that there is a collateral

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[91] One might compare these clauses with contract clauses providing that expert determination (e.g., regarding termination accounts or adaptation of contracts) is conclusive and binding (see *infra*, Chapters 9 and 12).

[92] See Articles 9 and 14 of the 1980 Rome Convention on the law applicable to contractual obligations.

[93] Brandner, in *Ulmer/Brandner/Hensen, AGB Gesetz*, 8th ed., Cologne, Otto Schmidt Verlag, No. 636; German Supreme Court, November 26, 1984, *NJW* 1985, 623 at 630.

agreement between the parties.[94] In American law, these clauses (often called merger clauses) are aimed to render the application of the parol evidence rule precise and to attempt not so much to exclude contradicting terms but to provide for complete integration and, thus, to preempt prior or contemporaneous additional agreements. Traditionally, these clauses were upheld by U.S. courts as reflecting the parties' intentions, but there is also a tendency to review whether these clauses comply with the real intentions of the parties. In this latter perspective, entire agreements clauses are strong indicators of party intent but are not conclusive.[95]

However, in common law jurisdictions, entire agreement clauses are not intended to exclude extrinsic evidence to prove the meaning to be given to ambiguous contract terms,[96] to exclude terms implied by law and to fill contract gaps. It is recommended to distinguish clearly between the exclusionary purposes of an entire agreement clause and interpretative guidelines given to judges and arbitrators. In this latter respect, one should reflect whether one intends to exclude terms implied by law, to fill gaps or to exclude extrinsic evidence for solving ambiguities. Generally, caution is in order because any such exclusions may raise difficult problems if the written contract proves to contain gaps or ambiguities. These over-inclusive clauses may then create rather than solve problems. Contract drafters should be aware that they cannot provide for all contingencies and that it may be an illusion to be able to create complete and unambiguous contracts.

Reference may also be made to CISG, which does not contain an explicit provision regarding the application of rules of evidence such as the parol evidence rule that has led to some controversy over whether the parol evidence is compatible with the Convention in sales litigation.[97]

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[94] A.G.J. Berg, *op. cit.*, 171.

[95] *Farnsworth on Contracts, op. cit.*, II, 223ff.

[96] *Farnsworth on Contracts, op. cit.*, II, 253 stating that an entire agreement clause may restate the "plain meaning rule" but is unlikely to be enforced if going beyond that point. See also E.A. Farnsworth, The Interpretation of International Contracts and the Case of Preambles, *I.B.L.J.*, 2002, pp. 275–277 who emphasizes that an entire agreement clause may convince courts to declare that a contract clause is clear and, thus, needs no interpretation.

[97] For a CISG-case where summary judgment on the issue of the non-application of the parol evidence rule was refused, see *MCC-Marble Ceramic Center Inc. v. Ceramica Nuova D'Agostino S.p.A.*, 1998 U.S. App. Lexis 14782, 1998 WL 343335 (Ct. App. 11th Cir.). This decision was followed in two District Court cases where the parol evidence rule was rejected in CISG-cases (*Mitchell Aircraft Spares Inc. v. European Aircraft Service AB*, October 10, 1998, 23 F. Supp. 2d 915, 1998 U.S. Dist. Lexis 17030, 1998 WL 754801 (U.S. District Court N.D. Illinois, Eastern Division) and *Calzaturificio Claudia s.n.c. v. Olivieri Footwear Ltd.*, April 6, 1998, 1998 WL 164824 (U.S. District Court, S.D.N.Y.). For the application

One should note the compromise solutions regarding merger clauses proposed by the Unidroit Principles and the PECL. Under Article 2.1.17 of the Unidroit Principles, the parol evidence rule is ruled out and extrinsic evidence is admissible to supplement or even contradict a written contract. However, if the parties have inserted a *merger* clause,[98] the article provides that any such clause is to exclude supplementing or contradicting the written contract by extrinsic evidence, but statements or agreements may still be invoked to interpret the writing. Similarly, Article 2:105 PECL provides that merger clauses imply that prior statements, undertakings or agreements do not form part of the contract, but prior statements may still be used to interpret the contract. There are, however, some differences with the Unidroit Principles. First, the PECL attempt to protect against general conditions both in consumer transactions and business transactions. This protection was not deemed necessary under the Unidroit Principles, which apply only to international commercial contracts and which may have worldwide application. The PECL are, however, intended to re-state contract law in the European Union only, and protection against general conditions was considered necessary. Thus, the PECL state that merger clauses, which are not individually negotiated, only create a presumption that prior statements, undertakings or agreements do not form part of the contract. Consequently, the burden of proof is reversed and a consumer or merchant faced with general conditions used by the other party might produce extrinsic evidence to supplement or contradict the written instrument. In that case, the merger clause is weakened and amounts to a reversal of the burden of proof. Second, the PECL—unlike the Unidroit Principles—state that their rule on merger clauses regarding protection against general conditions cannot be excluded or restricted by agreement. Third, the PECL rule providing that merger clauses do not affect the interpretation of contracts and the use of prior statements and understandings to that effect can only be excluded or restricted by an individually negotiated clause. Finally, unlike the Unidroit Principles, the PECL have an express waiver rule for

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of the parol evidence rule, see *Beijing Metals & Minerals Import/Export Corp. v American Business Center, Inc.*, 993 F.2d 1178 (5th Cir. 1993) approved by D. Moore, The parol evidence rule and the United Nations Convention on Contracts for the International Sale of Goods: Justifying Beijing Metals & Minerals Import/Export Corp. v American Business Center, Inc., *Brigham Young Univ. Law Rev.*, 1995, p. 1347 and the criticism by H. Fletchner, More U.S. Decisions on the U.N. Sales Convention: Scope, Parol Evidence, "Validity" and Reduction of Price under Article 50, 14 *J.L. & Com.* 1995, p. 153. See also C. Giovannucci Orlandi, Procedural Law Issues and Uniform Law Conventions, *Rev. Dr. Unif.*, 2000, pp. 32–36; P. Galleo, The Inapplicability of the Parol Evidence Rule to the United Nations Convention on Contracts for the International Sale of Goods, 28 *Hofstra Law Rev.*, 2000, pp. 799–833. As to this controversy, it is relevant to note that, in 2004, the CISG Advisory Council in its third opinion has expressed the proposition that there is no room for the parol evidence rule in CISG cases.

[98] The comment to Article 2.1.17 at p. 64 also describes these clauses as integration clauses.

merger clauses under which a party, by his statements or conduct, can be precluded from asserting a merger clause to the extent that the other party has reasonably relied on this statement or conduct.[99]

For international commercial contracts, both principles indicate that entire agreement clauses are gaining international acceptance, but that their scope is limited to excluding supplemental or contradicting extrinsic evidence. On the other hand, these clauses should not affect the interpretation of the contract where extrinsic evidence is admitted to show the effects to be given to the contract terms of the written contract. These international restatements may have *persuasive authority* in civil litigation before national courts and, thus, they may affect the interpretation to be given to entire agreement clauses under the national law applicable to the contract. Furthermore, under modern arbitration laws characterized by freedom for arbitrators to rule on means and admissibility of evidence, both principles may be invoked by parties and applied by arbitrators to do away with the parol evidence rule and to uphold the binding effect of entire agreement clauses.

It is perhaps preferable to avoid these problems in international contract practice rather than have them solved in litigation or arbitration while invoking the Unidroit or European Principles. Quite dramatically, most entire agreement clauses do not precisely reflect what functions parties want to attribute to them. Neither do they provide for indications as to their substantive or procedural nature. The analysis above has indicated that major legal systems have no problems with the enforceability of entire agreement clauses as agreements to substance, as evidence agreements or as both substance and evidence provided the entire agreement only purports to exclude additional and/or contradicting terms. If so, the question arises why these clauses generally do not reflect this function any better.

When entire agreement clauses are not drafted precisely to cover only the issue of additional and contradictory terms, the risk arises that they are interpreted in civil law jurisdictions to address other issues such as solving ambiguities, filling of gaps or imposing obligations by implication. Any such—mistaken—interpretation causes an unnecessary clash between the more substantive approach of civil law countries, which questions the effects of these poorly drafted entire agreement clauses, and the procedural perspective of the common law, under which these clauses tend to be interpreted restrictively and are deemed binding and to have the intended exclusionary effects.

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[99] On all these aspects, see A. Hartkamp, Formation of Contracts According to the Principles of European Contract Law, Festskrift til Ole Lando, Papers dedicated to Ole Lando, Copenhagen, Gadjura, 1997, 180.

Since there is no case law and scant literature on these issues, the analysis must remain tentative and provisional. The general conclusion is that—perhaps with the exception of English style jurisdictions and American law—entire agreement clauses aiming at excluding pre-contractual documents and evidence, which may establish terms contradicting or adding to the written terms of the contract, have not yet been tested and that, therefore, they may not work out to be as rigid as would appear from reading these clauses. However, a few guidelines may be added to this cautious conclusion. First, the specific wording of the entire agreement clause should be taken as the starting point of any analysis since the research has shown some variety in the way these clauses are drafted. Secondly, there may be a significant difference in attitude to these clauses between arbitration and court litigation. Thirdly, the consequences to be attached to these clauses to a large extent depends upon their characterization as substantive or procedural. Fourthly, the law applicable to these clauses also affects their interpretation.

In practice, the implication of this analysis probably is that most entire agreement clauses copied from contracts governed by the rules of a common law jurisdiction are ambiguous or at the least unclear to the mind of lawyers trained in civil law jurisdictions and, thus, unfit to be used if the applicable law is the law of a civil law jurisdiction. Therefore, most clauses are to be re-drafted in order to be adaptable in a civil law context or to be able to be used as a boilerplate clause in international contracts irrespective of the fact whether the governing law is the law of a common or civil law country. Re-drafting would then permit covering the functions parties intend the clause to have and to express whether the clause is to have substantive or procedural content. Subsequently, the re-drafted provision is to be scrutinized against the law applicable to the contract or, alternatively, the provision is to be drafted in a way that is compatible with the law in most jurisdictions. The latter would imply that the clause is not to be drafted as an evidence clause because in some jurisdictions, there is doubt as to the validity of any such clause. Entire agreement clauses must focus more on their functions and effects and less on their Anglo-American origin. Stating that a contract constitutes the entire agreement between the parties does not help; neither does it help to say that the written contract supersedes prior and contemporaneous terms. From a civil law perspective, it is better to draft the clause in such a way as to express that terms agreed upon by the parties, which add to or contradict the written contract terms, will be ineffective or are deemed to have been waived. One might add that, to the extent permitted by the applicable law, the contract in writing shall constitute conclusive evidence between the parties and that no other evidence shall be admitted to establish terms adding to or contradicting the agreement in writing.

Finally, it should be noted that the application of entire agreement clauses may be waived expressly or by conduct. Often non-waiver clauses will attempt to shield entire agreement clauses from the application of waiver doctrines (see further Section III.H).

4. *Exclusion of Written or Oral Representations*

Fourthly, entire agreements may intend to shield against actions by one of the parties to have the contract declared null and void on the basis of misrepresentation or mistake. In practice, any such clauses may be important to avoid complex transactions that are attacked on these bases by a party intending to go back on its contractual promise and exposing the other party to high costs and uncertainty. Such clauses might read as follows:

- "This Agreement, together with any agreements and other documents to be delivered pursuant or concurrently hereto constitutes the entire agreement between the Parties pertaining to the subject matter hereof[100] and supersedes all prior agreements, negotiations, discussions and understandings, written or oral, between Parties. There are no representations, warranties, conditions, other agreements or acknowledgments, whether direct of collateral, expressed or implied, that form part of or affect this Agreement. The execution of this Agreement has not been induced by, nor do either of the Parties rely upon or regard as material, any representations, warranties, conditions, other agreements or acknowledgements not expressly made in this Agreement or in the agreements and other documents to be delivered pursuant hereto."
- "Complete Agreement. This Agreement, together with all other agreements contemplated hereby, constitute the complete and exclusive statement of the agreement between the Partners and replace and supersede all prior agreements, by and among the Partners or any of them. This Agreement supersedes all prior written and oral statements and no representation, statement, condition or warranty not contained in this Agreement shall be binding on the Partners or have any force or effect whatsoever except as set forth in this Agreement or in any other agreement contemplated hereby."

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[100] The following clause is somewhat broader, since it does not only cover prior arrangements pertaining to the subject matter of the contract but also to matters connected therewith:

> "This Transfer and Assignment Agreement and Consent constitutes the entire agreement between the parties hereto and supersedes and cancels any and all prior representations, negotiations, undertakings, letters, acceptances, agreements, understandings and contracts whether verbal or written between the parties hereto or their agents solely with respect or in connection with any of the matters or things to which this Transfer and Assignment and Consent applies or refers."

- "The parties hereto further acknowledge and agree that, in entering into this Agreement and in delivering the schedules, documents and instruments to be delivered on or before the Closing Date they have not in any way relied, and will not in any way rely, upon any oral or written agreements, representations, warranties, statements, promises, information, arrangements or understandings, express or implied, not specifically set forth in this Agreement or in such schedules, documents or instruments."

These clauses have frequently been found in merger and acquisition contracts where the value of the transaction is based upon due diligence reports and an audit of the company to be merged with or to be acquired. In the course of the audit, many documents may be reviewed by the audit team (for instance in a data room for reasons of confidentiality). Thus, disclosure duties by either party (in case of a merger) or by the seller (in case of an acquisition) are replaced by investigation duties by the counter-party. The system intends to shield the transaction from attack as to its validity or as to price or exchange correction based on mistake or misrepresentation save for those representations that are expressly stated in the representation and warranties part of the written agreement. Entire agreeement clauses purport then to exclude any other oral or written representations or any documents or other evidence on which a representation might be construed.

Some clauses go further and add the effects of these clauses to the effect that mistake and misrepresentation cannot entail rescission of the contract or give rise to tort liability:

> "Each party further agrees and undertakes to the other that no breach of this agreement shall entitle it to rescind this Agreement, and that its remedies for any breach of this Agreement shall be solely for breach of contract, which remedies shall be subject to and in accordance with the provisions of this Agreement."

Finally, some exceptions may be provided such as fraudulent misrepresentation:

> "This agreement and its schedules constitute the entire agreement made between the parties. It supersedes and replaces all other agreements whether in writing or otherwise with regard to the same subject, including the memorandum of understanding exchanged by the parties and dated 13 October 1999. Nothing in this agreement shall operate to exclude liability in respect of fraudulent misrepresentation."

These clauses may be helpful indicators to help block actions to nullify the contract. They may be more easily enforceable under the common law than in civil law jurisdictions. For instance, there is English case law stating that any such clause is generally valid but that it is to be interpreted in a restrictive way. Therefore, if the parties have intended that the contract cannot be nullified or that no other remedies (such as tort remedies) should be available, this should be expressly stated in the clause.[101]

In civil law countries, it is unclear whether the contracting parties may, by contract, regulate the formation process of contracts. A traditional theory advocates that the rules on formation are mandatory to protect contracting parties against abuses from the other party and, that therefore any such clause would be invalid.[102] A more liberal camp argues that some contract formation rules are dispositive and that the parties may derogate from these rules.[103] This conception did find its way to the new Dutch Civil Code (Article 217(2) Book 6 providing that the parties may derogate from contract formation rules), but that does not extend to misrepresentation. Similarly, Article 6 of CISG (the 1980 Vienna Convention on the International Sale of Goods) stipulates that the parties may opt out of the entire Convention or of parts thereof. This also relates to the rules on formation of sales contracts. However, pursuant to Article 4 CISG, Article 6 does not apply to national rules regarding the validity of contracts where CISG is silent. The modern conception, however, does not yet seem to be relevant for purposes of the application of doctrines of mistake and misrepresentation where the law still seems to be, by and large, mandatory. However, Article 3.19 of the Unidroit Principles and Article 4:118 PECL are paving new ways regarding their non-mandatory rules on mistake and misrepresentation.

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[101] A.G.J. Berg, *op. cit.*, 172; R. Christou, *Boilerplate: Practical Clauses*, 2nd ed., London, FT Law & Tax, 1995, pp. 179–185 (citing two unpublished decisions one of which has been published since, see *Witter Ltd v. TBP Industries*, [1996] 2 All E.R. 573 (Chancery Division, Jacob J, July 15, 1994). In a recent case (*Grimstead v. McGarrigan* [1999] Court of Appeal), it was held that the combination of written exhaustive representations and an entire agreement clause is reasonable in commercial transactions and may preclude a claim based on misrepresentations not contained in the written contract (see Baker and McKenzie Commercial Law Newsletter, Janury 2000).

[102] For Belgium, see for instance G. Baeteman, Les effets des dispositions légales impératives protégeant des intérêts privés, case note under Belgian Supreme Court, December 6, 1956, *R.C.J.B.*, 1960, p. 164.

[103] See R. Moser, *Vertragsabschluß, Vertragsgültigkeit und Parteiwille im internationalen Obligationenrecht*, St. Gallen, Fehr, 1948, pp. 101–127; W. Lorenz, Contribution, in Ricordando Gino Gorla, Centro di studi e richerche di diritto comparato e straniero, Saggi, conferenze e seminari No. 6, Rome, 1993, p. 12.

The type of entire agreement clauses discussed in this section may therefore have more factual than legal relevance. These clauses make it more difficult for a claimant to convince a judge or arbitrator that it was led by a mistake or misrepresentation because, under the contract, that party acknowledged that there were no other representations than those of the contract. The ambit of representation can thus, *de facto*, be reduced to the expressly worded representations contained in the contract. By virtue of the clause, there would be less room to invoke oral representation or representations given in documents other than the contractual documents except in case of fraud or when the one party was under an obligation to inform the other and the scope of that information duty cannot validly be limited to the contractual representations.

In sum, this fourth category of entire agreement clauses may have factual dissuasive force but its legal status in many jurisdictions is still uncertain if not doubtful.

5. *Exclusion of General Conditions: Blocking Clauses*

Entire agreement clauses may also function as blocking clauses (*clauses de défense, Abwehrklauseln*) against general conditions. The problem of conflicting general conditions (*battle of forms*) and the variety of answers in comparative law is widely known[104] and causes uncertainty in international trade. However, if contracting parties are in a standing business relationship with one another under a distributorship, license, franchising or construction contracts where there is a main contract and implementing or additional contracts, the manufacturer, licensor, franchisor or contractor may attempt to exclude the application of the general conditions of the other party by means of a blocking clause in the entire agreement clause of the main contract. Often, these clauses are one-sided in favor of the party having the strongest bargaining position, but one example has been found of a symmetric clause in a distributorship contract:

> "This Agreement contains the entire agreement between the parties with respect to the subject matter hereof and in particular the exclusion of any standard conditions of sale of purchase of either party and may not be modified except by an Instrument in writing signed by the duly authorised representative of each party."

All these clauses do not seem to create major problems regarding their validity and application. It is legitimate for the parties to determine the

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[104] Dutch law has the first shot theory where as English law the last shot. France, Belgium and Germany have the principle that conflicting general conditions cancel one another to the extent of the conflict. The UCC and Article 19 CISG have a mixed theory distinguishing between material and non-material deviations between offer and acceptance.

scope of their contractual duties not only positively by defining the contractual documents (see Section B.3) but also negatively by excluding general conditions that may contradict or supplement the contract. However, these blocking clauses only seem to cover and protect the scope of the contract in which they are contained, but do not solve the problem of a battle of forms between the general conditions of both parties as to the implementing or additional contracts. If any such effect is desirable, a more extensive blocking clause would be required such as the following:

> "Entire Agreement
>
> Seller and Distributor agree that above terms and conditions included in the Attachements and the terms and conditions in Seller's order acknowledgement form, if any, or as changed or modified in the future at seller's discretion, are the only terms and conditions of the distributorship and of the sale by the Seller and purchase by Distributor of the Products and that the terms and conditions of this Agreement and of Seller's order acknowledgements form shall override any terms and conditions stated in any order or acknowledgements forms or any other document supplied by Distributor.
> Seller shall not be bound by any terms, conditions or prices stated in the Distributor's purchase orders, acknowledgements forms or other documents which vary, limit or add to the terms, conditions or prices of this Agreement."

Any such clause may be binding on the same contracting parties for later contracts provided the formation of these contracts does not indicate that the blocking clause had been waived by one of the parties.

6. Exclusion of Future Contracts and Documents

Contracts can not only be followed by contracts under which general conditions are used but also by implementing, ancillary or other contracts or by other documents that may vary the contract. Here too, contract drafters do not want their contract to be affected by implementing, ancillary or other later contracts or documents. For instance:

- "Toute divergence par rapport aux termes et conditions du présent contrat et de toute annexe y relative qui serait contenue dans tout bon de commande ou toute autre notification écrite de la partie A sera nulle et non-avenue."
- "It is expressly agreed that if Client issues a purchase order or other document for the products and services provided under this Agreement, such documents will be deemed to be for Client's internal use only, and the terms and conditions of this Agreement shall supersede any provisions therein."

In both these cases, one party intends to provide for a contractual protection against any variation of the contract by the other party.[105] However, one could also draft clauses in a more symmetric way.

This category of entire agreement clauses does not create specific problems, and these clauses generally will be upheld and be declared binding and enforceable unless it appears that any such clause has been inserted as a boilerplate and does not fit within the letter or the spirit of the contract. Implementing or ancillary contracts are often related to earlier framework contracts and will be held not to constitute completely different contracts but are implementing or ancillary to the main contract depending also on the provisions of that contract. In other cases, the position may be weaker if modifications have been proposed and performance took place in accordance with the proposed modifications. These clauses in practice—under certain circumstances and subject to the applicable law—may be considered to have been waived if performance appears to conflict with the letter of the clause.

In practice, these clauses pursue objectives similar to NOM- and non-waiver clauses in that they attempt to freeze the contract into the written form existing upon conclusion (see Sections III.G and III.H). It may be recommended to draft these clauses purporting to exclude future contracts or documents in the context of such NOM- and non-waiver clauses since they are the flipside of the same coin. Since the parties do not intend to have the contract modified in an informal way by future contracts or documents, any such variation should be expressed in writing in accordance with the provisions of the NOM-clause. Also, parties want to protect themselves against variation by conduct, for instance by not objecting to future documents and contracts. The non-waiver clause fulfills just that objective.

As a general conclusion to entire agreement clauses, parties should first clearly identify the different objectives they may have in mind regarding these clauses. In a boilerplate clause, the six functions mentioned earlier should be considered. Secondly, in international contracts, one needs to be aware of the different meanings and approaches these clauses may have in different jurisdictions, particularly contracts between parties coming from civil and common law jurisdictions. Thirdly, the entire agreement clause is to be scrutinized against the background of the law applicable to the contract. Finally, most clauses encountered in the analysis seem to be in need of reconsideration and re-drafting when they are to be used in the context of a contract governed by the law of a civil law jurisdiction because these clauses are not properly understood in these jurisdictions.

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[105] These clauses are to be distinguished from clauses giving one party a unilateral right to change some elements of the contract (see R. Christou, *op. cit.*, pp. 184–186).

D. Heading Clauses

Entire agreement clauses in their multiple functions attempt to freeze the contract in its written form. Once the contract has been so defined, the interpretation process may begin to solve ambiguities, gaps and internal contradictions. In the interpretation process, one looks first to the literal meaning of contract clauses. The research has indicated that contracts hardly provide anything to help literal interpretation. The next step is looking at context. In that respect, the structure of the contract is used as a context for interpretation.

One element in this respect is the interpretative value of headings (*intitulés*). Before analyzing that question, the question should be answered as to why contracting parties use headings preceding their contract articles. The reason is twofold and of a contract management nature. First, headings summarize contract provisions and thus, the contract is made user-friendly because one can easily find the relevant contract clauses in lenghty contracts without having to read them from beginning to end. This reference objective of headings is not only important for contract drafters but also for all the people (present and future) in a company who may have to go through the contract documents. Third parties such as banks financing contracts, governments involved in the process of permits or credit insurance companies may benefit from headings. Second, headings are essential in making tables of contents of contracts and the heading thus repeated in the table of contents serves the same reference function as the headings preceding the contract articles.

From a legal point of view, the question arises whether these headings may help to interpret contracts. Under the different interpretation theories found in different jurisdictions (see Section II), the answer is positive. Under the English approach, headings may be part of the literal interpretation process. Under the subjective theory, they may form indications of what the parties wanted and under the objective theory they are also elements to determine the rights and obligations of the parties.

However, in international contract practice[106] one notes a frankly hostile attitude against giving interpretative value to headings.[107] This is prob-

[106] In legislation headings are also used, for instance in Switzerland and the United States and maybe used for legislative interpretation(for the United States, see UCC § 1–109).

[107] This hostile attitude is also confirmed by the FIDIC contracts where the Red Book provides:

> "1.2 The headings and marginal notes in these Conditions shall not be deemed part thereof or be taken into consideration in the interpretation or construction thereof or of the Contract." (Clause 1.2 of the Conditions of

ably due to the fact that contract drafters want to be protected against themselves and prefer to exclude from the outset any interpretative value, inspired by fear of inconsistencies between the clause and its heading and the partial and summary character of the heading. Many contracts express these concerns and contain almost identical language stating:

- "Les titres d'articles ne font pas partie du Contrat et ne sont mentionnés qu'à titre indicatif."
- "Descriptive Headings
  The descriptive headings of the various clauses of this Agreement are inserted for convenience only and do not constitute part of this Agreement."
- "Headings and Table of Contents. The headings to all Sections and subsections, the Table of Contents contained in this Agreement and all Exhibits thereto, shall not form a part of this Agreement or Exhibits, but shall be regarded as having been used for the convenience of reference only."
- "Headings of the Clauses
  The headings or titles of the Clauses of this Agreement do not constitute a part thereof, their inclusion serving only to facilitate its use."

The clauses above merely indicate that headings and table of contents are not a part of the contract in the sense that the parties did not want to create contractual rights or obligations. However, there may be some doubt whether these clauses may be construed to exclude the interpretative value of headings and table of contents. The following clauses are, therefore, preferable because they clearly take a position regarding the interpretative status of headings and table of contents:

- "Captions and Headings. The section and paragraph captions and headings contained in this Agreement are for included reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement."

Contract for Works of Civil Engineering Construction—The Red Book, FIDIC, Lausanne, 4th ed., 1989).

Similar provisions may be found in clause 2(i) of the Client/Consultant Model Services Agreement—The White Book, FIDIC, Lausanne, 2nd ed., 1991; clause 1.2 of the Conditions of Contract for Electrical and Mechanical Works—The Yellow Book, FIDIC, Lausanne, 3rd ed., 1988; clauses 1.2.1 and 1.2.2 respectively of FIDIC's Sub-Consultancy and Joint Venture (Consortium) Agreements, FIDIC, Lausanne, 1994; clause 1.2 of the Conditions of Subcontract for Works of Civil Engineering Construction, FIDIC, Lausanne, 1st ed., 1994; clause 1.2 of the Conditions of Contract for Design-Build and Turnkey—The Orange Book, FIDIC, Lausanne, 1st ed., 1995. *Adde* the four new 1999 standard form of contracts published by FIDIC and mentioned *supra*, note 1.

One may add that international financial organizations such as the World Bank also have these heading clauses in their contracts.

- "Headings. The section headings used herein are inserted only as a matter of convenience of reference, and in no way define, limit or describe the scope of this Agreement or the intent of any provision thereof."
- "Headings. All headings herein are inserted only for convenience and ease of reference and are not to be considered in the construction or interpretation of any provision of this Agreement."

There is scant doubt as to the validity of any such clauses,[108] but one may question whether and to what extent these clauses will be effective in jurisdictions following the objective theory, where judges may engage more in judicial activism regarding interpretation because it is a legal issue and because party autonomy is only one criterion in contract interpretation and certainly subject to court intervention in cases of abuse. The hostile and unqualified nature of these clauses has been criticized, and the question has been raised whether exceptions should not be formulated in drafting these clauses. A general reservation may be advisable to preempt the automatic operation of these clauses. For instance, one might provide that headings and table of contents are inserted for convenience and reference and shall not affect the construction of the contract or of any of its provision unless such construction leads to unequivocal conclusions. A positive formulation might read that headings and table of contents are inserted for convenience and reference and may be considered in the construction of the agreement or of any of its provisions provided it does result in unambigous conclusions.

E. Definition Clauses[109]

Interpretation problems can, to a large extent, be avoided if terminology is properly defined and consistently used. If a term is used once in a contract clause, the definition of that term may be placed in that same provision. For instance,

> "For the purposes of this clause the expression "Material Breach" means . . ."

If terms are used often in a contract, one may consider having a definition clause at the beginning of the contract. Again, this technique is used in order to increase the user-friendliness of contracts but also to avoid differences of opinion regarding key concepts.

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[108] In an unpublished ICC Interim Arbitral Award dated March 7, 1994 (Case 7273), a heading clause denying legal effect to the wording of the heading was applied by the arbitral tribunal. The parties during negotiations had contemplated arbitration and inserted this in the heading. However, the final contract did not contain an arbitration clause while the heading still referred to arbitration. The Tribunal held that, on that basis alone, it could not accept jurisdiction.

[109] See also M.H. Malevillc, *op. cit.*, pp. 74–83.

Two different classes of definitions can be distinguished. First, there is the definition of grammatical concepts:

- "Gender/Number. Whenever the context of this Agreement so requires, references of the masculine gender shall include the feminine or neuter gender and corporate or other such entities, the singular number shall include the plural and vice versa, and reference to one or more parties hereto shall include all assignees of that party."
- "Interpretations 1.3 Words importing persons or parties shall include firms and corporations and any organisation having legal capacity."[110]
- "Singular and Plural 1.4 Words importing the singular only also include the plural and vice versa where the context requires."[111]

Second, concepts typical or relevant for the contract concerned will be defined. These definition clauses can be very long and, in one contract, related to the sale of a business division, the definition clause took 14 pages defining some 98 different concepts. The purpose of this analysis is to look to the introductory provisions of these definition clauses. The first category contains the simple and straightforward introductory phrases such as:

- "Definitions. Throughout this Agreement, the following terms shall have the following meanings: . . ."
- "Definitions 1.1 In the Contract (as hereinafter defined) the following words and expressions shall have the meanings hereby assigned to them: . . ."[112]

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[110] Conditions of Contract for Electrical and Mechanical Works—The Yellow Book, FIDIC, Lausanne, 3rd ed., 1988 (clause 1.3); Conditions of Contract for Works of Civil Engineering Construction—The Red Book, FIDIC, Lausanne, 4th ed., 1989 (clauses 1.3); Conditions of Subcontract for works of Civil Engineering Construction, FIDIC, Lausanne, 1st ed., 1994, (clause 1.3); Conditions of Contract for Design-Build and Turnkey—The Orange Book, FIDIC, Lausanne, 1st ed., 1995 (clause 1.3). *Adde* the 1999 four new FIDIC standard forms of contract cited *supra*, note 1.

[111] Conditions of Contract for Works of Civil Engineering Construction—The Red Book, FIDIC, Lausanne, 4th ed., 1989 (clauses 1.4); Conditions of Contract for Electrical and Mechanical Works—The Yellow Book, FIDIC, Lausanne, 3rd ed., 1988 (clauses 1.3). For similar provisions, see Clause 2 (ii) of the Client/Consultant Model Services Agreement—The White Book, FIDIC, Lausanne, 2nd ed., 1991; Guide to the use of FIDIC's Sub-Consultancy and Joint Venture (Consortium) Agreements, FIDIC, Lausanne, 1994 (clause 1.2.2 of the Sub-Consultancy Agreement and clause 1.2.1 of the Joint Venture (Consortium Agreement); Conditions of Subcontract for works of Civil Engineering Construction, FIDIC, Lausanne, 1st ed., 1994, (clause 1.4); Conditions of Contract for Design-Build and Turnkey—The Orange Book, FIDIC, Lausanne, 1st ed., 1995 (clause 1.3). *Adde* the 1999 new FIDIC standard forms of contract cited *supra*, note 1.

[112] Clause 1.1 of the Conditions of Contract for Electrical and Mechanical Works—The Yellow Book, FIDIC, Lausanne, 3rd ed., 1988.

However, substance may dictate that the same concept is used in different meanings. The following clause provides for that situation and adds a qualification to the sweeping nature of a definition clause:

> "In this Agreement unless otherwise stated:
>
> Confidential Information means . . .
>
> Goods mean . . ."

Many definition clauses, however, do not refer to an exception to the definition to be provided by the drafters but to an exception based on context that, ultimately in case of a dispute, is to be determined by a judge or arbitrator:

> "Definitions. In this Agreement, including the recitals, unless the context otherwise requires, the following words and expressions shall mean: . . ."[113]

This reference to context may generally be welcomed because it protects against automatic applications of definitions and because it brings these definition clauses more in line with subjective and objective interpretation theories of applicable national laws thereby avoiding clashes between the applicable law and the contract clause.

Sometimes, in groups of contracts, a definition clause refers to definitions of another contract as is the case in this definition clause of a sub-contract referring to the main contract:

> "Definitions 1.1 In the Subcontract (as hereinafter defined) all words and expressions shall have the same meanings as are respectively assigned to them in the Main Contract (as hereinafter defined), except where the context otherwise requires and except that the following words and expressions shall have the meanings hereby assigned to them: . . ."[114]

This may raise the problem of conflicting definitions where the following clause provides the answer in giving a priority rule:

> "Words and expressions defined in the Contract shall, unless the context otherwise requires, have the same meanings in this

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[113] All the FIDIC Conditions cited *supra*, note 1, except for the Yellow Book clause cited in the previous note have a similar provision.

[114] Clause 1.1 of the Conditions of Subcontract for Works of Civil Engineering Construction, FIDIC, Lausanne, 1st ed., 1994.

Agreement; provided that if the same term is defined both in the Contract and in this Agreement, it shall, for the purpose of this Agreement, have the meaning set out in this Agreement."

Definition clauses may also attempt not so much to define concepts but to describe the contents of a concept by giving an enumeration of events or circumstances falling within the concept. The key issue is then to determine whether the contractual enumeration is exhaustive or exemplary. Contract clauses better avoid interpretation problems that may, for instance, arise in common law jurisdiction by operation of the rule *expressio unius exclusio alterius* or of the *eiusdem generis* rule by clearly stating the nature of these enumerations by wording such as "including but not limited to."

Definition clauses may be very helpful in defining key concepts and warrant consistency. There is a growing tendency to have very extensive definitions clauses, and one may ask whether all the concepts defined really need definition. Common sense is in order, and drafters should always carefully review whether they have not forgotten key concepts in their quest for detail perfection and completeness.

Generally, definitions will bind judges and arbitrators in English style jurisdictions and in countries following the subjective contract interpretation model.[115] In objective model jurisdictions, courts will take the definitions seriously but may depart from them if the context were to require so.

Finally, it is recommened that definition clauses should refrain from creating contractual rights and obligations. A strict division between definition clauses and substantive clauses avoids confusion and enhances the consistency of the contract.

F. Language Clauses

International contracts, by their very nature, may often involve parties speaking different languages. This raises the sometimes delicate question of the language of the contract and the communication language of the parties.[116] International contract practice also has dealt with these issues. The following is an example of a language clause setting forth the language of the contract immediately followed by a translation into the language of the other party:

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[115] For France, see M.H. Maleville, *op. cit.*, p. 80.

[116] See J. Gruber, *Auslegungsprobleme bei fremdsprachigen Verträgen unter deutschem Recht*, DZWir 1997, pp. 353–359.

"The Parties have expressly required that this Agreement and all documents and notices relating hereto be drafted in English. Les parties aux présentes ont expressément exigé que la présente convention et tous les documents et avis qui y sont afférents soient rédigés en langue anglaise."

This clause had been inserted in a contract where one party had its place of business in Québec and this kind of clause may be found particularly in multi-lingual jurisdictions such as Canada, Belgium or Switzerland.

If several language versions of the same contract are made, the question is how discrepancies between the different versions are to be solved. Many clauses have provisions to that effect, which may also reflect the bargaining positions of the parties. For a case where both versions control, see the following example:

"Languages and Counterparts
This Agreement is signed in two sets of original copy in both English and Chinese. Each Party shall retain one set of original copy. Each copy will have the same legal validity."

These clauses may cause problems because they do not solve eventual discrepancies between the equally binding language versions. An answer may be found in the following clause:

"This Agreement has been executed by the parties in two original counterparts, one in French and the other in the English Language. In the event that one of the counterparts should differ from the other and the parties cannot in good faith agree on a common interpretation, the matter shall be settled by arbitration in accordance with Article 13 hereof."

However, most contracts have a priority rule defining the ruling language:[117]

- "Langue
  La langue de la présente Convention et de ses Annexes ainsi que de toute correspondance qui en sera la suite est le français. Si des traductions en d'autres langues étaient nécessaires, seul le texte français ferait foi.
  Tous les documents, autorisations ou autres qui doivent être remis au Chef de File dans le cadre de la présente Convention et dont

[117] See also the FIDIC Conditions cited *supra*, note 1 which all have provisions concerning the language versions of the contract and the day-to-day language for the contract works or services.

les originaux ne seraient pas en langue française devront être accompagnés d'une traduction émanant d'un traducteur juré, si le Chef de File en fait la demande."

- "Texte authentique:
  Au cas où le texte de ce présent Contrat existerait dans une langue autre que le français, la version française prévaudra sur toute autre version."
- "Authentic text
  Should the text of this Agreement exist in other languages than the English one, the present English version shall prevail over all other language versions."
- "Section 17: Language
  The official language of this Agreement is English, and the American usage thereof shall control the interpretation and construction of it and of all other writings between S and B. In the event of a discrepancy in translation of this Agreement, the English language version shall be controlling."

The following clause is a diplomatic and elegant way to emphasize the equality of the parties and of their languages and presents the issue of solving discrepancies as a pragmatic one:

> "This Agreement shall be executed in both the English and the Spanish language. The English and Spanish texts shall both be valid, provided that in the event of any discrepancy and the resolution of a dispute the English text shall prevail."

Some clauses also give insights as to the reason why one language version controls the other one:

- "The translation of these general terms of sale has been made for Buyer's facility; in case of dispute concerning the interpretation of these terms, only the enclosed French text is valid."
- "These general terms and conditions were originally drawn up in the Dutch language and in case of any difference between Dutch and translated versions, the Dutch version is ruling."

These language clauses work automatically and do not provide for exceptions or qualifications. The priority rule is established immediately in case of a conflict between the two language versions. One wonders whether an intermediate step might not be advisable. With that approach, the different language versions are mutually explanatory and the ruling language only prevails if mutual explanation fails.[118] These intermediate solutions,

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[118] In this regard, experience from multilinguistic jurisdictions such as Belgium,

again, may reduce tension between language clauses and national laws, primarily those based on the objective theory that may be tempted to intervene in the interpretation process by using the non-ruling language in contravention of the language clause.

G. NOM-Clauses (No Oral Modification Clauses)

Once a written contract has been made, circumstances and situations may arise that require that the contract be changed. In many jurisdictions, there is no need to have commercial contracts in writing and modifications are thus also not subject to a written form.[119]

From Section III.C on entire agreement clauses, the conclusion was that contracting parties spend a lot of effort in reducing all arrangements to one written document and attempt to concentrate all these arrangements in one single document. This contract management concern is legitimate but may be frustrated if, subsequently, oral contracts are concluded between the parties that deviate from the written contract or if written amendments are made by unauthorized employees.

For that reason, no oral modification clauses (hereafter referred to as NOM-clauses) have been developed that provide a parallel formalism regarding changes to the written contract and require that amendments be made in writing.[120] NOM-clauses are, in a way, the complement of entire agreement clauses. However, if the parties do not see any need to insert an entire agreement clause into their contract, NOM-clauses may still be very useful in order to force the parties to record amendments in writing. These amendments may then be filed with the original contract and complete the

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Canada and Switzerland as to the interpretation of legal texts in different languages may be useful.

[119] There are exceptions to this rule in some Latin American countries, in some Central and Eastern European countries and under Statutes of Frauds in some common law jurisdictions. Furthermore, some particular clauses in commercial contracts such as forum selection clauses and arbitration clauses may be subject to a requirement of being in writing. Under CISG, there is no requirement as to sales contracts being in writing (Articles 11 and 29) but countries may make a stipulation under article 96 to that effect. Finally, some requirements may affect the validity of the contract, whereas other requirements only relate to evidence.

[120] No oral prolongation clauses (NOP-clauses), under which a fixed term contract can only be extended in writing, are similar to NOM-clauses. For an application of such a clause by the European Court of Justice as to forum selection under Article 17 of the Brussels 1968 Convention on Jurisdiction and Enforcement (now Article 23 of Regulation 44/2001) where it was held that, subject to the applicable law, a forum selection clause in the original contract meeting the requirements of Article 17, may be extended to later contracts which were renewed without observing the contractual requirement of a written statement (ECJ, November 11, 1986, Iveco Fiat/Van Hool, ECR 1986, 3337).

contract file necessary for contract management purposes and guarantee continuity in the contract or legal department.

The ICC Model Agency and Distributorship Contracts may be cited as examples of NOM-clauses:[121]

> "Article 26.2. No addition or modification to this contract shall be valid unless made in writing. However a party may be precluded by his conduct from asserting the invalidity of additions or modifications not made in writing to the extent that the other party has relied on such conduct."

Other examples:

> "Modifications
> Toute modification de la présente Convention et de tout autre document s'y rattachant devra faire l'objet d'un accord écrit des parties."

Next to these simple clauses, there are some more sophisticated clauses that have provisions as to who has to sign the modification contract, the form it should take, the date of its entry into force or a requirement that reference be made to the original contract:

- "Amendment
  No amendment or other variation of the Contract shall be effective unless it is in writing, is dated, expressly refers to the Contract, and is signed by a duly authorized representative of each party hereto."
- "Modifications
  Any modifications or amendments to the CONTRACT will be made by RIDER in writing to the CONTRACT."
- "This Agreement contains the entire agreement between the parties and it cannot be altered or amended unless by mutual consent and in writing. Any alterations or amendments agreed upon between the parties shall stipulate the date as from which they become effective."

NOM-clauses also attempt to protect companies against changes proposed and agreed upon between the other contracting party and any of the companies' employees, officers, sales representatives or agents not having

[121] For other examples, see Article 1.5 of the ICC Model International Sales Contract, ICC Publication No. 556, Paris, ICC Publishing, 1997; Guide to the Use of FIDIC's Sub-Consultancy and Joint Venture (Consortium) Agreements, FIDIC, Lausanne, 1994 (clause 2.5 of the Sub-Consultancy Agreement).

authority to bind the company. In these cases, the clause intends to shield the company from being bound by virtue of arguments related to apparent authority (*mandat apparent*) and estoppel. Only a minority of the clauses covered these cases explicitly and it would be advisable that NOM-clauses also address these issues in much more detail.

In one clause, an exception was provided where an oral modification was permissible, probably regarding a minor item:

> "This Agreement cannot be changed or terminated orally with the sole exception that cities may be added to and/or deleted from the list of cities in Exhibit A by oral agreement of the parties hereto."

The merits of NOM-clauses have already been emphasized. They have increasingly been used and found their way into some national laws and into codified uniform law. As to the former, during the research no statutory provisions or case law regarding NOM-clauses has been found in civil law jurisdictions.[122] Under the subjective theory of interpretation prevailing in France and Belgium, NOM-clauses seem to be binding unless it can clearly be shown that parties have renounced it, whereas under the objective theory prevailing in Germany or The Netherlands it will be more easily accepted that one party waived his right to invoke the NOM-clause by agreement or by conduct or is acting in an unreasonable way (*Rechtsverwirkung*). In relation to Germany, there is the additional complication that arises if the variation to the contract is communicated to the other party by means of a merchant's confirmation note (*kaufmännische Bestätigungsschreiben*). The question is then to know whether the NOM-clause or the confirmation note should prevail.

With regard to the common law, there are some specific elements in the United States regarding NOM-clauses that briefly will be summarized. Traditionally, the common law accepted that written contracts, subject to Statutes of Frauds, could be varied orally based on the argument that the parties could change a contract at any time after a contract had been concluded, including the NOM-clause contained in any such contract. The parol evidence rule is not applicable to these cases since it only precludes evidence regarding prior, not subsequent terms. However, in Section 2-

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[122] Two exceptions may be noted. First, Swedish law would seem to take the same approach as CISG, see J. Ramberg, The New Swedish Sales Law, in Centro di studi e ricerche di diritto comparato e straniero, Saggi, conferenze e seminari, 28, Roma, 1997, 7–8. Secondly, under German law, Section 9 of the Statute on General Conditions (now Section 307 BGB) restricts the use of NOM-clauses (see for instance, German Supreme Court, February 15, 1995, NJW 1995, 1488). This provision is also applicable to commercial transactions, provided the applicable law is German law.

209(2) UCC, this position was changed in sales contracts, and under that new provision a signed agreement, which excludes modification except by a signed writing, cannot be otherwise modified. A waiver rule was added to this provision (Section 2-209(4) UCC).[123]

As to uniform law, Article 29 CISG provides in Article 29(2), first sentence that a contract in writing, which contains a provision requiring any modification or termination by agreement to be in writing, may not be otherwise modified or terminated by agreement. The second sentence of Article 29(2) makes this rule subject to a waiver provision, which will be discussed below (see under Section III.H). Thus, Article 29 CISG recognizes the use of NOM-clauses in international trade.[124] Article 29 CISG also sets the trend for Article 2.1.18 of the Unidroit Principles, which has an identical wording and also makes clear that an oral modification cannot be interpreted as an implicit renunciation of the NOM-clause. Article 2:106 PECL, on the other hand, states that a NOM-clause is only a rebuttable presumption that an agreement to modify or end the contract is not intended to be legally binding unless it is in writing. Contrary to Article 29 CISG and Article 2.1.18 of the Unidroit Principles, which establish substantive rules favoring party autonomy, the PECL allow a party to prove that the parties have chosen a form other than to modify or end the contract and thus, provide for more flexibility.[125] The PECL reduce NOM-clauses to procedural clauses reversing or determining the burden of proof. The comment indicates that the guiding principle for such a procedural conception is good faith since it would be contrary to good faith to deny a party the right to prove a modification or termination if the other party agreed to that effect but later invokes the NOM-clause. The PECL being clearly influenced by the objective theory, in fact, reduces the impact of the NOM-clause. This illustrates again that different perceptions of contract interpretation may influence the scope that is given to interpretation clauses.

When international contracts are not governed by CISG, different perceptions of the applicable national law might result in different treatment of NOM-clauses. This may also be the case in international arbitration because the Unidroit Principles and the PECL have different approaches

[123] On all these aspects, see Farnsworth on Contracts, *op. cit.*, II, 245–251 and F. Rothermel, Role of Course of Performance and Confirmatory Memoranda in Determining the Scope, Operation and Effect of "No Oral Modification" Clauses, 48 *Univ. Pittsburgh Law Rev.* (1987), pp. 1239ff.

[124] See R. Hillman, Article 29(2) of the United Nations Convention on Contracts for the International Sale of Goods: A New Effort at Clarifying the Legal Effect of 'No Oral Modification' Clauses, 21 *Cornell Int. Law J.*, 1988, pp. 449–466. For an application of a NOM-clause and Article 29 CISG and Article 2.1.18 Unidroit Principles, see ICC Arbitral Award, Case 9117, 10 *Bull. Cour. Int. Arb.* ICC, 1999, No. 2, p. 96.

[125] A. Hartkamp, *op. cit.*, p. 181.

to the effect to be given to NOM-clauses. Contracting parties may be advised to clarify their position regarding the various issues of this debate and to have it reflected in their NOM-clause in order to give indications to judges and arbitrators. Under the subjective theory and the literal system of interpretation, NOM-clauses thus clarified seem to be binding, whereas, under the objective theory, this cannot be guaranteed. Finally, after having discussed the binding effect of NOM-clauses, the question arises whether these clauses are enforceable if it is alleged that the parties have varied the agreement orally or in a written form that does not conform with the requirements of the NOM-clause. This situation will be subject to the different notions and requirements of the applicable law regarding waiver and similar concepts. Also, the solution will depend upon the presence of a non-waiver clause in the contract. Since waiver and non-waiver clauses are discussed in the next section of this chapter, the reader is referred to that section for further information (see Section III.H).

So far, NOM-clauses have been considered from a substantive point of view. During the research, no indications have been found for arguments considering that NOM-clauses may be characterized as evidence agreements excluding any evidence establishing that the parties have varied the written contract by oral agreement, by course of conduct or in any other way that does not comply with the requirements of the NOM-clause. If parties were to intend NOM-clauses to have any such effect, this should be expressly stated in the clause.

H. Non-Waiver Clauses

One of the crucial problems with entire agreement and NOM-clauses is to determine their effects if one party acts in contravention of these clauses and subsequently invokes these clauses. Under national legal systems, there are correction mechanisms based on principles of implied renunciation, *venire contra factum proprium*, waiver by agreement or by conduct, estoppel or *Rechtsverwirkung*.[126] If these corrections are put in place, their effect is to derogate from entire agreement and NOM-clauses.

Contracting parties often want to protect themselves against these surprises from national law and, therefore, provide for a defense line based on a contractual clause rejecting any kind of waiver. These clauses may be called *waiver clauses* because their subject matter is related to waiver issues. If one looks at their function to shield against waiver-related arguments, these clauses may be referred to as *anti-waiver clauses* or *non-waiver clauses*.

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[126] See *L'interdiction de se contredire au detriment d'autrui*, M. Behar-Touchais, (ed.), Paris, Economica, 2000.

At least two different sets of non-waiver clauses may be distinguished. The first category deals with entire agreement and NOM-clauses and provides that the written contract forms the entire agreement between the parties and can only be modified in writing. Subsequently, these clauses tackle the problem whether obligations other than those stemming from the written contract may be imposed upon the parties based upon a waiver of the entire agreement and NOM-clauses. One example may be cited to draw the picture:

> "Entire Agreement, Waiver. This Agreement, including the Schedules hereto, constitutes the entire agreement between the parties pertaining to the subject matter hereof and there are no representations, warranties or other agreements between the parties in connection with such subject matter. Except as expressly provided in this Agreement, no amendment, waiver or termination of this Agreement shall be binding unless executed in writing by each party to be bound thereby. No waiver of any provision of this Agreement shall constitute a waiver of any other provision nor shall any waiver of any provision of this Agreement constitute a continuing waiver unless otherwise expressly provided. No failure or delay on the part of any of the parties to exercise any right, power, or privilege hereunder shall operate as a waiver thereof, nor shall any single or partial exercise of any right, power or privilege under this Agreement preclude any further exercise thereof or the exercise of any other right, power or privilege."

Entire agreement, NOM- and non-waiver clauses do not have to be used in conjunction, as in the previous example. Combinations of only NOM- and non-waiver clauses are often found. For instance,

> "No modification of the Contract is valid unless agreed or evidenced in writing. However, a party may be precluded by this conduct from asserting this provision to the extent that the other party has relied on that conduct."[127]

All these non-waiver clauses refer to the written contract and are attempts to freeze the contract in the sense that the contract terms need to be enforced except where the contract has been amended in writing. For that reason, a failure to enforce contract terms is not to be deemed a waiver in that particular case nor for future cases:

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[127] Article 1.5 of the ICC Model International Sale Contract, ICC Publication No. 556, Paris, ICC Publishing, 1997. For similar provisions, see Article 26 of the ICC Model Commercial Agency Contract, ICC Publication No. 644, Paris, ICC Publishing, 2002 and Article 26 of the ICC Model Distributorship Contract, ICC Publication No. 646, Paris, ICC Publishing, 2002.

"Failure to insist upon strict compliance with any of the terms, covenants, or conditions hereof shall not be deemed a waiver of such terms, covenants, or conditions nor shall any waiver or relinquishment of any right or power hereunder at any one or more times be deemed a waiver or relinquishment of such right or power at any other time or times."

These non-waiver clauses have gradually become more sophisticated in stating the circumstances that may constitute waiver. For instance,

- "Le Chef de File et/ou les Prêteurs ne seront pas considérés comme ayant renoncé aux droits qu'ils tiennent de la Convention et/ou des Billets à Ordre du fait qu'ils n'auraient pas exercé lesdits droits, qu'ils les auront exercés partiellement ou avec retard ou qu'ils n'auront exercé qu'un seul d'entre eux."
- "Variation/Waiver. Any amendment of this Agreement shall be binding upon the parties only if mutually agreed in writing and the variation or waiver of any terms or conditions with respect to any particular sale or transaction shall not be construed as a variation or waiver with respect to subsequent sales or transactions."
- "Failure of either party to insist upon the strict and punctual performance of any provision hereof shall not constitute waiver or estoppel in one case and shall not constitute a waiver or estoppel with respect to a later case, whether of similar nature or otherwise."

They also provide for procedures under which waiver may be accepted. In that respect, these clauses, in fact, repeat and rephrase NOM-clauses in saying that a waiver must be recorded in writing, signed by duly authorized representatives of the parties and/or provide the extent of the waiver. The following are examples of this kind of clauses:

- "Section 17.5 Waiver. None of the provisions of this Agreement shall be considered waived by a party unless such waiver is in writing and signed by such Party. No waiver shall be construed as a modification of any of the provisions of this Agreement or as a waiver of any default (present or future) hereunder or breach hereof, except as expressly stated in such waiver."
- "Non Waiver
  Subject to Clause . . . below, no relaxation, forbearance, delay or indulgence by either party in enforcing any of the terms and conditions of the Contract or the granting of time by either party to the other shall prejudice, affect or restrict the rights of that party under the Contract, nor shall any waiver by either party of any breach of the Contract operate as a waiver of any subsequent or continuing breach of the Contract. Any waiver of a party's rights,

powers or remedies under the Contract must be in writing, dated and signed by an authorized representative of the party granting such waiver, and must specify the right and the extent to which it is being waived."

The distrust of contract drafters regarding modifications of the written contract through waiver may be illustrated by the following two clauses that seem to exclude modification in writing of the contract by waiver because, in these clauses, waiver is seen as an incidental problem to be solved in an incidental way:

- "Any waiver of, or consent to depart form, the requirements of any provisions of this Agreement shall be effective only if is in writing and signed by the Party giving it, and only in the specific instance and for the specific purpose for which it has been given."
- "This Agreement may not be amended or modified except by an instrument in writing signed by, or on behalf, the Seller and the Purchaser. Waiver of any term or condition of this Agreement shall only be effective if in writing and shall not be construed as a waiver of any subsequent breach or waiver of the same term or condition, or a waiver of any other term or condition of this Agreement."

A second set of non-waiver clauses, which may be conceived, but were not found in the research, does not merely refer to the written contract but generally refers to deviation from existing contractual arrangements, practices and course of dealing. These non-waiver clauses, which have a much broader scope than the ones of the first category, attempt to protect not only from derogations from the written contract but more generally from the situation existing between the parties as that situation is based on written and oral arrangements or on practices or course of dealing.

The effect of non-waiver clauses is to be tested against the applicable national law. Under the English model with literal interpretation, they generally will be enforced. The same holds true for jurisdictions such as France, which follow the subjective model and where contract terms will be binding and effective except for an abuse of a contractual right or where one might argue that the non-waiver clause has been waived by a subsequent oral agreement. The chances that non-waiver clauses will be reviewed by courts may be higher in jurisdictions following the objective model were it to appear that the application of contract terms was waived. A party invoking the contract term may, under the law of these jurisdictions, be held to be estopped from doing so because the other party could legitimately rely on any such conduct. Good faith and fair dealing may then impose disregarding the non-waiver clause of the contract and enforcing the contractual obligations as they have developed in fact between the par-

ties. The non-waiver clause may then operate not so much as a substantive clause excluding waiver-related arguments but as a procedural clause increasing the burden of proof for the party invoking waiver.

For international sales contracts governed by CISG, Article 29(2), first sentence, CISG provides that the requirement to modify an international sales contract is modified in writing by virtue of a NOM-clause is effective. However, the second sentence of Article 29(2) adds that a party may be precluded by its conduct from asserting the NOM-clause to the extent that the other party has relied on that conduct.[128] In this respect, the CISG codifies for international sales law what national laws provide under theories of estoppel, legitimate reliance, *Nemo venire contra factum proprium* or *Rechtsverwirkung*. The question is then how Article 29(2) relates to the non-waiver clauses discussed in this section. Under article 6 CISG, the Convention contains only dispositive rules, and they can be excluded by the parties either completely or partially. If the parties have not completely opted out of CISG, one may wonder whether their non-waiver clause amounts to an exclusion of Article 29(2), second sentence CISG. Under a uniform interpretation of CISG under its Article 7(1), one might rely on the objective origins of CISG (see Section II) to argue that the position under CISG is similar to those jurisdictions that follow the objective theory. Consequently, judges under CISG might ignore the non-waiver clause if that clause would amount to permitting a party to deny conduct that, in itself, did not comply with the non-waiver clause.

By way of conclusion, one can say that non-waiver clauses may be useful, but under some legal systems may not give the protection they seem to provide upon first reading. If the contracting parties under these laws want to enforce the non-waiver clause in the way it has been written, they should at all times comply with the contract terms and not tolerate derogations unless any such derogations are properly managed by recording them in writing and setting forth the reasons, time limits and scope of these derogations.

I. Severability Clauses

Contract drafters having shielded their written contract by means of entire agreement, NOM- and non-waiver clauses, also frequently want to protect their product from invalidity. Clauses of invalidity, by and large being determined by mandatory rules of the applicable law, look much more to the consequences of invalidity. Many international contracts provide for *severability clauses* (*clauses de nullité partielle, clauses de divisibilité,*

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[128] Article 2.1.18 of the Unidroit Principles and Article 2:106(2) PECL contain similar provisions. The analysis set forth below applies to both Principles.

Salvatorische Klauseln) under which the nullity of one or several clauses does not necessarily entail the nullity of the complete contract. On the other hand, no examples were found of clauses imposing the interpretation to be in favor of the validity of the contract (*potius ut valeat*) or to convert an invalid contract into a valid one.

These severability clauses are not clauses purporting to determine the meaning or effects of contracts which are based on the understanding that the contract has been concluded and is valid. Rather they deal only with the consequences of nullity and do not solve the contract's ambiguities, gaps or contradictions. They are discussed here because they reflect the parties' intentions as to how partial invalidity should be solved.

Severability clauses are inserted to protect the parties against the dramatic consequences that may follow if the whole contract falls through, often with retroactive effect. However, one should note that many jurisdictions have already statutory or case law rules[129] on partial invalidity that attempt to solve these problems.[130] In international commercial contracts, where the governing law is the law of any of these jurisdictions, a severability clause is not necessarily required because one can fall back on the applicable law to solve the problem. However, contract drafters should consider that these national law rules are insufficiently precise and might, for that reason, supplement these rules with their own contract rules. For instance, the German, Swiss and Italian Code provisions permit severability if the parties also would have contracted without the annulled provision(s). Contract drafters may consider any such standard too conjectural and, therefore, prefer a regulation of their own. Whether they are successful in these attempts will be addressed in the conclusions of this section.

Furthermore, a severability clause may also be inserted in contracts submitted to the law of a jurisdiction that already has a rule on severability because the severability clause is a boilerplate clause and has not been taken out of the contract. The boilerplate character of the severability clause may, however, be helpful if it is unclear, from the outset, which law will govern the contract. A severability clause may then have the advantage that it is there in the contract, even if, during the negotiations, the applicable law changes in favor of a legal system that does not have a similar rule.

Severability clauses are, of course, most useful in relation to international commercial contracts governed by the law of a jurisdiction without

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[129] Section 139 German Civil Code, Article 20(2) Swiss Code of Obligations, Article 1419 Italian Civil Code, Article 3:41 Dutch Civil Code, UCC Section 1–108.

[130] See also Article 3.16 of the Unidroit Principles and Article 4:116 PECL regarding partial avoidance.

firm statutory or case law rules regarding partial invalidity.[131] In those jurisdictions, severability clauses are clear indications that the parties wanted to save the complete contract from invalidity (*clause dite de validité, favor validitatis*) and that, therefore, a single clause is not an essential element of the contract or can be severed from the other clauses.

The special status of arbitral clauses and forum selection clauses covering severability also needs mention. Under many laws, these clauses are considered severable. Their autonomous character is then based on the argument that the dispute resolution mechanism chosen by the parties should also become operational if the very existence of validity of the contract is raised.

After discussing the merits and possibilities of severability clauses, one must now turn to their analysis. A simple severability clause may read as follows:

> "If any provision of this contract shall be invalid or without effect in accordance to applicable law, the remaining provisons shall be valid and enforceable in accordance with their terms."

Sometimes, clauses limit the scope of the invalidity to the persons or circumstances affected by the invalidity or to the territory of the judge enforcing an international mandatory rule (e.g., export restrictions, boycott, anti-trust law[132]) of his forum:

- "And such invalidity or unenforceability shall not affect the application of such provisions to persons or circumstances other than those to which it is held invalid or unenforceable."
- "Le fait que l'une des stipulations de la Convention soit déclarée nulle, ou non susceptible d'exécution par une juridiction quel-

[131] These jurisdictions include France, Belgium and Québec. Under French law, judges must declare contracts null and void if maintaining the contract would be contrary to public policy. Otherwise, the contract may be saved if the provision to be declared null and void was not decisive in concluding the contract. A severability clause may be an important indication to that effect. Thus, the severance criterion seems to be primarily subjective (on these issues, see B. Mercadal, *op. cit.*, 401–402). Under Belgian law, nullity of one clause will result in the nullity of the complete contract if the clause cannot be severed from the other clauses of the contract. However, there are differences of opinions whether severance is to be determined on the basis of the intentions of the parties or in a objective way according to standards of reasonableness (see R. Kruithof, in R. Kruithof, H. Bocken, F. De Ly, & B. De Temmerman, *Overzicht van rechtspraak (1981–1992)*, Tijdschrift voor Privaatrecht, 1994, pp. 603–604).

[132] With regard to severability and European competition law, see Nos. 66 and 67 of the Commission Notice on Guidelines on Vertical Restraints, OJ October 13, 2000, C 291, 1–44.

conque, n'affectera en rien la légalité, la validité de ladite stipulation devant une autre juridiction ou la possibilité d'exécuter les autres stipulations de la présente Convention."[133]

Sometimes an exception is provided in relation to essential clauses. For instance,

- "10.10. Severability. Any provision hereof prohibited by or unlawful or unenforceable under any applicable law of any jurisdiction shall as to such jurisdiction be ineffective without affecting any other provision of this Agreement unless such provision is essential to the transactions herunder."
- "25.3. The nullity of a particular clause of this contract shall not entail the nullity of the whole agreement, unless such clause is to be considered as substantial, i.e. if the clause is of such importance that the parties (or the party to the benefit of which such clause is made) would not have entered into the contract if it had known that the clause would not be valid."[134]
- "Nullité partielle
  La nullité d'une clause au présent Contrat n'affectera toutefois pas les autres clauses du présent Contrat et n'entraînera donc pas son annulation sauf si la nullité de cette clause modifiait les intentions principales des parties au jour de la signature du présent Contrat."

Any such clauses can, however, also be formulated in a more objective way, which does refer not so much to the common intentions of the parties had they known about the invalidity but rather to whether the clause can be separated from the other clauses of the contract:

> "The parties hereto agree that, in the event of one or more provisions of this Agreement to be subsequently declared invalid or unenforceable by court or administrative decision, such invalidity or unenforceability of any of the provisions shall not in any way

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[133] For a clause which refers to a part of a clause being held invalid, see the following example:

> "Severability
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> If any provision of this Contract, or any provision hereof, applicable to any particular situation or circumstances is held invalid, the remainder of this Contract or the remainder of such provision (as the case may be), and the application thereof to other situations or circumstances shall not be affected thereby. The parties shall then negotiate and agree upon a valid provision coming closest to their intentions."

[134] Article 26 of the ICC Model Commercial Agency Contract, ICC Publication No. 644, Paris, ICC Publishing, 2002.

affect the validity or enforceability of any other provisions hereof except those which the invalidated or unenforceable provisions comprise an integral part of or are clearly inseparable from such other provisions."

Some clauses require that conditions are met before the severability clause may be called upon, such as the condition that the invalidity is declared by a court having jurisdiction over the case, or that a competent authority has indicated that the clause is invalid:

- "If any provision of this agreement is declared by a court of competent jurisdiction to be invalid, illegal or unenforceable, such provision shall be severed from this Agreement and the other provisions shall remain in full force and effect. . . ."
- "Severance
  In any provision of this Agreement or these Conditions is declared by any judicial or other competent authority to be void, voidable, illegal or otherwise unforceable or indications to that effect are received by either of the parties from any competent authority the parties shall amend that provision in such reasonable manner as achieves the intention of the parties without illegality or at the discretion of the Principal it may be severed from this Agreement and the remaining provisions of this Agreement shall remain in full force and effect . . ."

The clauses above do not address the consequences of partial invalidity but only state that the contract is saved except for the annulled clauses. However, many clauses contain provisions regarding the problem of filling the gap created by the disappearance of the annulled clause. Two approaches can in this respect, be followed. A first approach is to have the contract continue without the annulled clause:

- "Severability. The invalidity or unenforceability of any particular provision of this Agreement shall not affect the other provisions and shall not relieve either party from its obligations hereof, and such other provisions shall be construed in all respects as if such invalid or unenforceable provision were omitted."
- "In the event that any provision (or portion of a provision) of this Agreement is declared to be illegal, invalid or otherwise unenforceable by a court of competent jurisdiction, the remainder of this Agreement (and of such provision) shall not be affected except to the extent necessary to delete such illegal, invalid or unenforceable provision (or portion thereof), unless the deletion of such provision or portion thereof shall substantially impair the benefits of the remaining portions of this Agreement."

The second approach is to replace the invalid provision with a valid one.[135] One clause provided that any such replacement has retrospective effect.[136] Two main sets of clauses can be distinguished. First, there are clauses referring to the hypothetical intentions of the parties as, for example, in the following ones:

- "26.3. If any provision or clause of this contract is found to be null or unenforcable, the contract will be construed as a whole to effect as closely as practicable the original intent of the parties; however, if for good cause, either party would not have entered into the contract knowing the interpretation of the contract resulting from the foregoing, the contract itself shall be null."[137]
- "Should any provision of this agreement be entirely or partially invalid, the validity of the other provisions shall be unaffected. In place of an invalid provison, a valid provision shall be presumed to be agreed upon by the parties which comes closest to the one actually agreed upon."

Second, some clauses refer to more objective standards such as the spirit of the contract or the economic function of the contract:

- "Toute stipulations de la Convention qui s'avèrerait nulle, illégale ou non susceptible d'exécution, en tout ou en partie, sera dans toute la mesure du possible remplacée par la disposition la plus similaire possible en accord avec l'esprit de la Convention."
- "Nullité partielle
  Dans le cas ou certaines dispositions du présent Contrat seraient inapplicables pour quelque raison que ce soit, les Parties resteront liées par les autres dispositions du présent Contrat et s'efforceront

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[135] These approaches are not mutually exclusive, see for instance the following clause:

> "In the event that any one or more of the provisions of this Agreement shall for any reason be held to be invalid, illegal or unenforcable in any respect, such provision shall be deleted and the remaining provisions of this Agreement shall continue in full force and effect (to the extent that is not rendered meaningless) and, if necessary, shall be so amended as necessary to give effect to what the Parties have intended or reasonably would have intended when drawing up this Agreement."

[136] "Insofar as a replacement for any such provision is necessary in order to achieve the objective of the Agreement, the Parties shall meet as soon as possible and agree upon new provisions in the spirit of the Agreement and to the same economic effect as much as possible. Such new provisions shall be made legally valid and applied retroactively as of the date when the replaced provision had become invalid or unenforceable."

[137] Article 26 of the ICC Model Distributorship Contract, ICC Publication No. 646, Paris, ICC Publishing, 2002.

de remédier aux clauses inapplicables dans le même esprit que celui qui a préside à l'elaboration du présent Contrat."

- "Severability
If any of the terms and conditions of this Contract shall be or become unenforceable for any cause whatsoever, the ensuring lack of enforceability shall not affect the other provisions hereof, and in such event the parties hereto shall endeavour to substitute forthwith such other enforceable provision as will most closely correspond to the legal and economic contents of the said terms and conditions."
- "Si une ou plusieurs stipulations du présent contrat devai(en)t s'avérer non valable(s) ou nulle(s)
(1) les deux parties reconnaissent que toutes les autres dispositions du présent contrat, pour autant qu'elles demeurent d'application, restent valables; et
(2) toute stipulation non valable ou nulle sera modifiée, après concertation, par une clause semblable qui respectera le mieux possible l'objectif économique de la stipulation première."
- "The Members undertake to replace any such stipulation not valid by another one, which is suitable for the intended purpose under this agreement and which is most similar from an economic point of view."

In one clause, subjective and objective standards were combined:

"Should a single provision or clauses of this Supply Contract prove to be invalid or unenforceable or not having force, the other parts of this Supply Contract shall remain in force and the Parties will use their best efforts to prepare a new provision or clause corresponding to the common intentions and objectives of this Supply Contract taking into consideration the overall spirit of the Frame Supply Contract."

Some clauses provide for a way out if the nullity of a contract clause cannot be solved by means of replacing the nullified provision with a similar one in accordance with objective standards. The most obvious solution is to refer the issue to the parties for an amicable settlement or to the dispute settlement mechanism provided for in the contract:

- "Invalidity of Provisions
Each of the provisions contained in this Agreement is distinct and severable and a decision pronouncing the invalidity or unenfoceability of any such provision or part thereof by a court, agency or other body of competent jurisdiction shall not affect the validity or enforceability of any other provision hereof. Notwithstanding the

foregoing, the parties shall negotiate in good faith in order to agree the terms of a mutually satisfactory provision to be substituted for a provision found to be invalid or unenforceable."

- "If any provision of this Agreement which the parties agree is immaterial shall become null and void, this shall not affect the validity of the remaining provisions. If, within ninety days after a provision of this Agreement has been determined to be or to have become null and void, and the parties have neither agreed that such provision is immaterial nor agreed to a suitable mutually acceptable modification of this Agreement that will not be null and void, this Agreement may be referred to arbitration under Section 23."
- "If any term or provision of this Agreement shall be held to be illegal, invalid or unenforceable by a court of competent jurisdiction or the Board of Arbitrators pursuant to Section 18 above, the parties agree that the court or the Board of Arbitrators making the determination of invalidity or unenforceability shall modify this Agreement to reduce the scope, duration or area of the term or provision, to delete specific words or phrases, or to replace any invalid or unenforceable term or provision with a term or provision that is valid and enforceable and that comes closest to expressing the intention of the invalid or unenforceable term or provision, and this Agreement shall be enforceable as so modified."
- "Severability. If any terms or conditions of this Agreement should be adjudicated to be invalid or unenforceable, the remaing terms and conditions of this Agreement shall remain in full force and effect without regard to the invalid or unenforceable terms or conditions; however, a court of competent jurisdiction shall have the power to reform such invalid or unenforceable terms or conditions to the minimum extent necessary to render the same valid and enforceable in accordance with the original tenor thereof."

Another solution is to give parties an opportunity to terminate the contract under those circumstances:

"Severability
If the event that any provision or several provisions of this Contract shall be or become invalid, then the Parties hereto shall substitute such invalid provisions by valid ones, which in their economic effect come so close to the invalid provisions that it can be reasonably assumed that the Parties would have contracted also with these new provisions. In case such provisions cannot be found, the invalidity of one or several provisions shall not affect the validity of this Contract as a whole, unless the invalid provisions are of such essential importance for this Contract that it is to be reasonably assumed that the Parties would not have contracted this Contract

without the invalid provisions. In such a case the Party affected may terminate this Contract by written notice to the other Party with immediate effect without prejudice to the affected party's rights in law or in equity."

These termination option clauses may be symmetric or asymmetric. For an example of the latter, see the following clause:

"Severance
In any provision of this Agreement or these Conditions is declared by any judicial or other competent authority to be void, voidable, illegal or otherwise unforceable or indications to that effect are received by either of the parties from any competent authority the parties shall amend that provision in such reasonable manner as achieves the intention of the parties without illegality or at the discretion of the Principal it may be severed from this Agreement and the remaining provisions of this Agreement shall remain in full force and effect unless the Principal acting reasonably decides that the effect of such declaration is to defeat the original intention of the parties in which event the Principal shall be entitled to terminate this Agreement by 30 days' notice to the Agent and the provisions clause. . . . (Termination Consequences) shall apply accordingly."

Having analyzed contract practice regarding severability clauses, one should address their legal relevance. First, these clauses do not define which contractual provisions are essential or non-severable. The absence of any such listing makes it difficult to apply these clauses because the parties *in tempore non suspecto* did not identify the clauses that they consider essential or material in the absence of which they would not have contracted. Rather, the parties give general and vague guidelines as to when to save the contract. In the end, a judge or arbitrator will have to apply these guidelines; severability clauses in this respect do not provide the legal certainty that the parties envisaged when drafting the clause. The contracting parties seem to postpone a solution that is to be reached at a later time in mutual agreement or through court intervention. This pragmatic approach has the advantage of flexibility, which is wise since the reasons and scope of invalidity may be related to various reasons which are unforseeable at the time of contracting. New legislation or regulation or developments in case law may be examples of any such events. Second, these clauses remain highly valuable because they operate as signals that the parties want severability (symbolic regulation).

The better approach may then be to determine the procedure to be followed by the parties if part of the contract is affected by nullity. These procedural requirements are to be observed by the parties and aim at find-

ing ways out of the new situation created by partial nullification. At that stage, the parties are still in control of the process and the procedural elements of these clauses may form a barrier against immediately instituting court or arbitration proceedings. The mechanism is, in many ways, similar to the one often used in hardship situations.

Finally, the question remains whether there is party autonomy regarding the consequences of termination as a result of invalidity and, thus, whether these severability clauses are binding upon judges. The answer is probably negative but, in applying statutory and case law rules, judges can indirectly apply the severability clause thereby endorsing the view of the parties that the contract can be severed.

J. Gap Filling Clauses

Contracting parties often include some of the clauses discussed above in their contracts, particularly contract definition clauses (see Section III.B), entire agreement clauses (see Section III.C), headings (see Section III.D), definitions (see Section III.E), language clauses (see Section III.F), NOM-clauses (see Section III.G), non-waiver clauses (see Section III.H) and severability clauses (see Section III.I). We now proceed to a number of clauses (gap filling clauses, contract supplementation with custom, usages or course of dealing and good faith and fair dealing clauses), which are found rather infrequently in international commercial contracts. The reason that these clauses are less frequent in contracts is probably because these issues are already dealt with in the applicable national law and these rules cannot be easily formulated in contract term language.

Gap filling is barely addressed in international contracts. Only four clauses were found that extend the severability clause to gap filling under which the solution for partial invalidity is also applied to gap filling:

- "Should any provision of this Agreement be or become invalid or should this Agreement be found to contain a gap, the validity of the remaining provisions shall not be affected thereby. The invalid provision or the gap shall automatically be replaced or filled by such other provision coming, if and to the extent legally permitted, as close as possible to what the parties hereto have intended with the valid provision, in particular with respect to any invalid provision, time or period contained herein, or to what they have stipulated if they had considered the issues to be regulated."
- "In case any essential rulings of this Agreement should be or become null and void, or any such rulings contain necessary lackings, the Agreement shall nevertheless remain in force, and Parties in any such circumstances shall immediately come together and by

mutual consent negotiate bona fide an accomodation in order to replace the failing rule or complete the lacking one by such valid one which comes nearest to the economic purposes of the failing ones."

- "Clause above (the severability clause) shall apply accordingly if this Agreement is incomplete."
- "Diese Vorschriften gelten entsprechend wenn bei der Auslegung oder Durchführung des Vertrags eine ergänzungsbedurftige Lücke offenbar wird."

Apart from these four clauses, no other gap filling clauses were encountered during the research except for the following clause:

> "Eine solche Vertragslücke wäre von den Parteien gemäss Sinn und Zweck dieses Vertrages mit einer Ergänzungsvereinbarung zu füllen."

One may be referred to Article 1.2 of the ICC Model International Sale Contract[138] which—based on Article 7(2) CISG—states that questions relating to the contract, which are not expressly or implicitly settled by it, shall be governed by the CISG, and to the extent that such questions are not covered by CISG by reference to the law of the country where the seller has his place of business. However, this clause is much more a gap filler at the conflict of laws level than at the substantive level.

The gap filling clauses quoted above, generally will be enforced in most jurisdictions but, in states following the objective theory, they may be preempted by notions of good faith and fair dealing. In those countries, they may provide non-binding contract interpretation guidelines to judges and arbitrators.

Finally, it should be emphasized again that in common law jurisdictions, entire agreement clauses are not intended to address the problem of gap filling. Therefore, they do not impose literal interpretation under which there are serious restrictions as to the acceptance of implied terms nor *intro-interpretation* (i.e., interpretation on the basis of the text and context of the written instrument alone). Thus, gap filling in these jurisdictions is left to statutory or case law principles of interpretation under which the clauses cited above may be relevant. In civil law jurisdictions, one should avoid the trap of giving interpretative weight to entire agreement clauses as to gap filling. Therefore, entire agreement clauses as potential gap fillers are to be interpreted with great caution and—depending on their precise wording—are to be interpreted restrictively in the sense that in case of

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[138] ICC Publication No. 556, Paris, ICC Publishing, 1997.

doubt, they should be held not to address the issue of gap filling. For contract drafters, the recommendation is to clarify in entire agreement clauses that they address only the problem of contradicting or additional terms that have not been recorded in the agreement in writing, but are not intended to deal with gaps. In this latter respect, contract drafters might consider some specific clauses, as the ones cited above, to address gap filling or to leave it up to the law applicable to the contract.

K. Custom, Usage and Course of Dealing

The contracts, which formed the object of the research, also contained scant provisions referring to customs, usages and course of dealing. This may be because most of the contracts were tailor-made contracts, and that the standard contracts of the commodities sector were not analyzed.

In the limited number of clauses referring to custom, usage or course of dealing, two basic types can be identified. In one, references are sometimes made to practices of a certain branch of trade or to internationally widely known and used standard terms such as the Incoterms. For example,

- "To the extent applicable, the obligations of the parties are to be construed in accordance with practices of the international commercial bullion dealer market."
- "For the interpretations of commercial terms, reference shall be made to the 'International Rules for the Interpretation of Trade Terms' fixed by Incoterms 1953 of the International Chamber of Commerce, as well as by the additions and revisions applicable at the time of the conclusion of the agreement."
- "Incoterms
  Unless inconsistent with any provision of the Contract, the meaning of any shipping term and the rights and obligations of the parties thereunder shall be ascribed by "Incoterms." "Incoterms" means the international rules for the interpretation of trade terms published by the International Chamber of Commerce (2000 edition)."
- "Words which have a well known technical or trade meaning are used in this Agreement in accordance therewith."

On the other hand, one also notes a hostile attitude towards custom, usage, practices or course of dealing not so identified, because these may threaten the completeness of the written contract and jeopardize the objectives to be achieved by entire agreement, NOM- and non-waiver clauses. These clauses, for that reason, sometimes try to exclude custom, usage, practices and course of dealing. For instance,

- "Entire Agreement. It is agreed that this Agreement sets forth the entire understanding and agreement between the parties. No understanding, agreement or trade custom not expressly stated in this Agreement shall be binding on the parties in the interpretation or fulfillment of this Agreement unless such understanding, agreement or trade custom is reduced to writing and signed by the parties."
- "Either party's waiver of any breach or failure to enforce any of terms, covenants, conditions or other provisions of this Agreement, at any time, shall not in any way affect, limit, modify or waive that party's right thereafter to enforce or compel strict compliance with every term, covenant, condition or other provision hereof, any course of dealing or custom of the trade notwithstanding."
- "(. . .) and this Contract shall not be modified, varied or supplemented by any course of dealing, usage of the trade or otherwise except by a writing signed by the parties hereto."

The clauses mentioned above may be effective in most jurisdictions although, in countries following the objective theory of contract interpretation, they might be applied only indirectly and eventually be preempted by principles of good faith and fair dealing.

L. Good Faith and Fair Dealing Clauses

A third example of the contract drafters' inclination not to repeat statutory principles of contract interpretation may be found where good faith and fair dealing are concerned. Contract practice shows scant examples of parties referring to good faith and fair dealing as objective standards for contract interpretation. The clauses, which were found in long-term business contracts (such as requirement or cooperation agreements, joint ventures contracts or R&D agreements), emphasize the *intuitu personae* character of these contracts and the need for mutual cooperation and consideration for the interests of the other party:

- "Good Faith, Fair Dealing. The Parties hereto confirm that the spirit of mutual cooperation and goodwill underlie this Agreement, and that the parties shall perform the transactions contemplated hereunder bases on priciples of mutual cooperation."
- "Fairness and Good Faith
  The Parties declare it to be their intention that this Agreement and the Project shall operate between them with fairness and without detriment to the interest of either of them and that if in the course of this Agreement unfairness to either of them is anticipated or disclosed then the Parties will use all reasonable endeav-

ours to agree upon and thereafter to take such action as may be necessary to remove the cause or causes thereof."

- "Fairness and Good Faith
In entering into this Agreement the Parties recognise that it is impracticable to make provision for every contingency which may arise during the course of this Agreement. The Parties declare it to be their intention that this Agreement and the Project shall operate between them with fairness and without detriment to the interest of either of them and that if in the course of this Agreement unfairness to either of them is anticipated or disclosed then the Parties will use all reasonable endeavours to agree upon and thereafter to take such action as may be necessary to remove the cause or causes thereof."
- "In entering into this Agreement parties recognise that it is practically impossible to make provisions for every contingency which may arise during the validity of this Agreement. Accordingly, parties hereby state and acknowledge their mutual intent that this Agreement shall be enforced and implemented between them with fairness and without detriment to citer party's interest."

Other clauses focus more on the spirit of the contract and the need for the parties to act in accordance with that spirit:

- "Each of the parties hereto undertakes with each of the others to do all things reasonably within his power which are necessary or desirable to give effect to the spirit and intent of this Agreement and the Articles."
- "The Partners shall carry out the terms and provisions of this Joint Venture Agreement in accordance with the principle of mutual goodwill and good faith and respect the spirit as well as the letter of the said terms and provisions."

Finally, there are some clauses that impose a general duty of good faith and fair dealing regarding the performance of the obligations. These clauses have been found in an agency contract where the text of the ICC Model Agency Contract[139] had literally been copied:

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[139] Article 2 of the ICC Model Commercial Agency Contract, ICC Publication No. 644, Paris, ICC Publishing, 2002.

Similarly, article 2 of the ICC Model Distributorship Contract (ICC Publication No. 646, Paris, ICC Publishing, 2002) provides that:

"Article 2 Good faith and fair dealing

2.1. In carrying out their obligations under this contract, the parties will act in accordance with good faith and fair dealing.

"Good faith and fair dealing
In carrying out their obligations under this agreement, the parties will act in accordance with good faith and fair dealing.
The provisions of this agreement, as well as any statements made by the parties in connection with this agency relationship, shall be interpreted in good faith."

The above-mentioned clauses will not create major problems if the applicable law is the law of a jurisdiction endorsing the objective theory. For English-style jurisdictions and jurisdictions following the subjective theory, there may be the practical problem that one is not familiar with these open notions and that, in fact, they do not operate as hard and fast rules but as a delegation by the legislator and an invitation to adjudicate on the basis of objective standards. Judges or arbitrators, less familiar with this approach, might find it difficult to work with these contractual good faith and fair dealing clauses.

IV. CONCLUSIONS

From the analysis under Section III above, it appears that contracting parties often insert boilerplate interpretation clauses at the very end or beginning of contracts. Six out of the 12 classes of interpretation clauses identified in this report (i.e., entire agreement clauses, clauses regarding headings or language, NOM-clauses, severability and non-waiver clauses) are used in international commercial contracts drafted by Anglo-American lawyers but have also become frequent practice in contracts drafted by lawyers from civil law countries.

It is striking that contracts rarely refer to interpretation guidelines found in national legal systems or international conventions. Such interpretation canons (e.g., the *contra proferentem rule,*[140] the *favor validitatis* rule,[141]

2.2. The provisions of this contract, as well as any statements made by the parties in connection with this distributorship relationship, shall be interpreted in good faith."

[140] E.g., Article 4.6 Unidroit Principles, Article 5:103 PECL. Only one clause has been found where a similar rule was incorporated in a contract:

"19.03 Interpretation. Should the provisions of this Agreement require judicial or arbitral interpretation, it is agreed that the judical or arbitral body interpreting or construing the same shall not apply the assumption that the terms hereof shall be more strictly construed against one party by reason of the rule of construction that an instrument is to be construed more strictly against the party which itself or through its agents prepared the same, it being agreed that the agents of both parties have participated in the preparation herein equally."

[141] E.g., Article 1157 French and Belgian Civil Codes, Article 4.5 Unidroit Principles, Article 5:106 PECL.

contextual interpretation,[142] extensive interpretation[143] or objective standards[144]) are rarely inserted in contracts. This is quite understandable because contract drafters have other concerns than legislators. They may not see any interest in inserting already existing interpretation canons into their contracts. It is surprising that in all the contracts reviewed in the course of this project, not one single contract has a provision requiring a strict or literal interpretation of the contract. As has been noted in Section II, this interpretation technique is still prevailing in English contract law but contract drafters of contracts submitted to English law apparently do not find it necessary to repeat this literal approach in a contractual provision.[145] Furthermore, the English approach also does not seem to appeal to contract drafters of contracts governed by a law other than English law. Contract drafters will not consider inserting any such canon that is contrary to the interests they defend. A contract drafter will, for instance, not like the *contra proferentem* rule to be inserted in the contract he has been drafting.

In other situations, contract drafters may perceive a clear need and interest to address interpretation problems with proper contract language. This is true for contract definition clauses, ranking clauses, headings, concept definition clauses, language clauses, entire agreement clauses, NOM-clauses, non-waiver clauses and severability clauses. There is a clear tendency towards *documentalization* (*Dokumentenzwang*). Contract drafters want everything to be in writing in one document (including Annexes). Consequently, they want to exclude all prior arrangements, and future

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[142] E.g., Article 1161 French and Belgian Civil Codes, Article 4.4 Unidroit Principles, Article 5:105 PECL. For two examples in contract practice, see clause 5.4 of the FIDIC Red Book (Lausanne, 4th ed., 1989) which provides that the Contract documents shall be taken as mutually explanatory as well as the following clause:

> "3.4 Intention Contract as a whole
>
> The misplacement, addition or omission of a word or character shall not change the intent of any part of the Contract from that set forth by the Contract as a whole. Contractor shall be solely responsible for requesting any interpretation or clarification in such respect and shall bear any costs and expenses arising from his failure to do so."

[143] E.g., Article 1164 French and Belgian Civil Codes.

[144] See Articles 4.1–4.3, 4–8, 5.1–5.5 Unidroit Principles, Articles 5:102 and 6:101 PECL.

[145] In one book (A.G.J. Berg, *op. cit.*, p. 80), the suggestion has been made to exclude the English approach in contracts governed by English law by inserting the following clause:

> "To the fullest extent permitted by law, this Agreement shall be interpreted in a reasonable and commercial manner rather than in strict accordance with the literal meaning of the language used; and, in particular, due weight shall be given to the underlying business purposes of this Agreement and of the provision in issue."

arrangements must be recorded in writing, preferably as a rider to the contract. Documentalization is inspired by contract management reasons as well as by reasons of evidence.

The tendency to documentalization is an element of a broader trend to self-regulation under which the parties replace the uncertainties that may exist under applicable national laws with their own contractual rules that are perceived to provide for more certainty. This is clear from the analysis of entire agreement clauses where these clauses in common law jurisdictions attempt to avoid the uncertainties of the parol evidence rule. This also applies to (1) entire agreement clauses reducing the impact of national laws regarding mistake and misrepresentation (see Section III.C.4), (2) NOM-clauses where a written requirement regarding variation is introduced, (3) non-waiver clauses attempting to escape from waiver rules under the applicable law and (4) severability clauses that provide for self-regulatory substantive and procedural requirements regarding the consequences of partial invalidity of the contract.

As has become tradition, reports prepared by the Working Group end with some advice and suggestions to contract draftsmen. Naturally, it is recommended to be precise and accurate and to avoid ambiguity and repetition. Also, a well-drafted interpretation clause (at least as much as any other clause) is defective without an adequate choice of law clause and consideration of procedures to resolve disputes. As to interpretation clauses, one particularly notes clashes between various legal cultures, not only between the civil law and the common law but also within these legal families. Thus, contract drafters should be strongly discouraged from moving clauses from one legal family to another, and there is a great need to reconsider the drafting of many interpretation clauses in view of the differences noted.

Because of the wide variety of interpretation clauses discussed in this lengthy chapter, a brief summary of the interim conclusions of every section commenting on trends to documentalization of international contract practice is given here:

1. Characterization clauses serve positive functions in that they may identify the nature of the contract and the rules appplicable to the type of contract involved. To the extent that they have negative functions (i.e., attempt to exclude legal rules from being applied), they should be treated with great caution not only as to the mandatory rules they intend to evade or avoid but also regarding dispositive rules since judges and arbitrators may recharacterize the contractual characterization;
2. Clauses defining the contractual documents and their ranking are useful since they provide clarity. Parties may consider whether they

intend ranking clauses to operate in a strict manner or whether a more flexible drafting of the ranking clause would be preferable;

3. Once the contract documents have been defined, contract drafters, through entire agreement clauses, often intend to freeze the contract and exclude other documents. In this respect, entire agreement clauses serve exclusionary objectives. First, parties should clearly identify the different objectives they may have in mind when including these clauses: excluding side letters, previous contracts, pre-contractual documents, representations outside the written contract, general conditions and/or future contracts or documents. Each of these objectives deserve specific attention and drafting; no simple boilerplate clause or solution will do. One objective, however, warrants mention: when entire agreement clauses attempt to exclude pre-contractual documents, one should be aware of the different meanings and approaches these clauses may have in different jurisdictions, particularly in contracts between parties from civil and common law jurisdictions. Specifically under those circumstances, the entire agreement clause is to be scrutinized against the background of the law applicable to the contract. In common law jurisdictions, this type of clauses purports to protect against the uncertainties of the *parol evidence rule* under which no evidence may be admitted to show that the parties agreed on terms other than the written ones of the contract that contradict these terms or add terms to the contract. However, neither this rule nor entire agreement clauses prevent filling gaps, showing that the contract has been modified subsequent to its conclusion nor interpreting ambiguities. In civil law jurisdictions, the use of entire agreement clauses of this type creates the risk that these clauses may be interpreted to exclude extrinsic evidence to fill gaps, to solve ambiguities or to rule on contract variation. If so interpreted, these clauses seem to be at odds with substantive contract interpretation traditions. If these consequences are intended, one may consider re-drafting entire agreement clauses as evidence clauses excluding any such evidence concerning these objectives. If it is intended only to exclude agreed terms contradicting or supplementing the agreement in writing, these clauses are also in need of re-consideration and re-drafting to better reflect that they only exclude these additional or contradicting terms. Re-drafting may strengthen the binding nature of entire agreement clauses under substantive contract law. Subject to the law applicable to the contract, they might also be re-characterized as waiver clauses regarding any such additional or contradicting terms;
4. Heading clauses are useful tools for contract management; they make the contract user-friendly and help to prepare an index and a table of contents. The frankly hostile attitude of contract practice

to exclude any interpretative value of headings seems to be too unqualified, and it may be recommended to look for appropriate drafting to reflect that headings are drafted primarily for reference purposes and that headings should not have decisive weight in contract interpretation;

5. Definition clauses intend to avoid repetitions in key concepts and contribute to greater contract consistency. They should not contain rights and obligations of parties. Attention to detail should not divert from essential contract elements in need of definition. Contract drafters should reflect upon the issue whether they want strict definitions or whether some flexibility is in order. In this latter respect, a clause such as "*Unless the context otherwise requires, . . .*" might be a good choice;
6. Language clauses in international contracts clarify the controlling language(s) for contract interpretation. The bargaining positions of the parties are, to a large extent, reflected in the clauses that were the subject of the analysis. However, the language clauses may be too unqualified. Contract drafters should consider language clauses stating that the different language versions of the contract are mutually explanatory and that one version controls only if—after interpretation—the conflict persists;
7. No oral modification clauses (NOM-clauses) attempt to shield against contract variation. Under these clauses, contracts may change only if the requirements of the clause are met. These requirements generally include a written form but may also provide for further conditions. These clauses are tested if it is alleged that the contract has been modified but not in accordance with the requirements of the clause. Under waiver provisions of the applicable law, these clauses may become ineffective. To strengthen the objectives pursued by a NOM-clause, parties generally combine such a clause with a non-waiver clause. One may also consider adding an evidence clause under which a party, invoking waiver by agreement or conduct, has the burden of proof;
8. Non-waiver clauses have objectives similar to NOM-clauses in avoiding that the written contract stipulations are to become obsolete by an oral or other agreement of the parties. They may also have broader ramifications as they may attempt to protect the agreement in writing from being modified by subsequent conduct. As such, they provide a contractual regulation intended to replace legal rules regarding waiver. Whether and to what extent this contractual regulation is effective will depend upon the applicable law. In this respect, these clauses may not be as effective as their wording would suggest;
9. Severability clauses are not, strictly speaking, interpretation clauses but have been encompassed in this report because they reflect the

parties' intentions as to the effects to be given to a partial nullification of the contract. They provide for clarification in jurisdictions where there are no statutory rules on partial invalidity as well as in countries where the statutory standards for dealing with partial invalidity are too open-ended. Severability clauses deal with questions such as whether and how an invalid provision is to be replaced, whether subjective and/or objective standards are to be used in relation to such a replacement process and which procedure is to be followed in this process. One notes a pragmatic approach to the standards to be used. Also, procedural guidelines for the replacement process are very important since they impose upon the parties a duty to negotiate to keep the contract in place with a new contractual provision to replace the invalid contract clause.

In themselves, interpretation clauses vary so much according to the contractual context that we refrain from making other specific recommendations of general application.

CHAPTER 4
BEST EFFORTS, REASONABLE CARE, DUE DILIGENCE AND GENERAL TRADE STANDARDS IN INTERNATIONAL CONTRACTS

I. INTRODUCTION

When one party to a contract undertakes to perform a given act, the wording of its undertaking is often couched in a variety of terms intended to define the way in which the duty is to be carried out. A distributor, for example, will agree to use "his best efforts" to develop sales of a product; a bank will take "reasonable care" to check the authenticity of a document; a contractor will carry out work "diligently" and "according to industry standards."

What is the significance of such expressions? Do they merely help to explain the normal content of the obligation, or do they alter its intensity? If so, do they place the person who shoulders the duty in a weaker, or a stronger, position?

These are probing questions, given the great frequency with which expressions of this type appear in all kinds of international contracts. The terrain is fraught with difficulties. On the one hand, a great variety of expressions is used in drafting contracts and, in many cases, seemingly without any great discrimination. On the other hand, many of these expressions may have specific interpretations depending on the law governing the contract, interpretations of which the parties may not necessarily be aware.

The issue is part of the complex problems arising from concepts "of variable scope" found in great numbers in every legal system,[1] such as "good faith," "equity," "public order," "bonnes mœurs" (morals), "public interest," or the concepts of "normal," "manifest," "legitimate," "serious," "gross," "abusive" and many others.

Research, however, must be limited to its terms of reference, and for the purposes of this chapter the Working Group concentrated on four

[1] Cf. Centre National de Logique, *Les notions à contenu variable en droit*, Cl. Perelman & R. Vander Elst (eds.), Brussels, 1984.

major criteria: "best efforts," "reasonable efforts" (in French, "*meilleurs efforts*" and "*efforts raisonnables*")," "due diligence" and references to "general trade (or industry) standards" (in French, "*règles de l'art*") in all their varying formulations. The Working Group further limited its study to the ways in which these terms define how an obligation must be performed, its nature and intensity. The word "reasonable," in particular, is obviously used in many other contexts (e.g., "reasonable" time, "reasonable" indemnity, etc.); these are not considered here, except insofar as they are incidental to the issues at hand.

Some typical examples encountered by the Group will give the reader an insight into the practice of contractual drafting (Section II). The second part of the chapter will analyze that practice and synthesize the main conclusions (Section III); the chapter ends with the usual advice to negotiators (Section IV). The basis is around 150 sample clauses, gleaned from a variety of international contracts.[2]

II. CONTRACTUAL PRACTICE

"Best efforts," "reasonable care" and "due diligence" clauses, as well as references to accepted industry standards, tend to appear mainly in certain types of contracts or clauses.

A. Illustrations

1. *Types of Contract*

a. Distribution Agreements and Sales Promotion

In a distribution agreement, the distributor often undertakes to promote sales of the products concerned. This type of undertaking is one of the main areas in which the parties may decide to refer to the "best efforts" or "reasonable efforts" criterion.

- "The distributor agrees to use its best efforts to sell, promote, market and support the Products and to develop and maintain the reputation and goodwill of . . . and the Products in the Territory with Distributors' customers."
- "During the period of the Permission, the licensee shall use its reasonable endeavours to sell and to increase the sale of the Licensed Products in Benelux . . ."

[2] On these clauses, also see C. Chappuis, Les clauses de *best efforts, reasonable care, due diligence* et les règles de l'art dans les contrats internationaux, *Rev. Dr. Aff. Int.*, 2001, pp. 281–301; D. Philippe, Les clauses de Best Efforts, in *Liber amicorum Guy Horsmans*, Brussels, 2004, pp. 905–942.

In each case, it is clear that a duty has been undertaken, but no explanation is given of its scope, which causes difficulties in interpretation. What is the scope of "best efforts" and "reasonable endeavours" in this context? Is there a difference between the two terms?

What then should one make of the following formula where different criteria are brought together:

> "The Licensee shall endeavour in every reasonable and proper way and to the best of his ability to further the sales of the said [machine] containing such patented improvement."

The model agency contract prepared by the International Chamber of Commerce also bundles criteria:

> "The Agent agrees to use *his best endeavours* to promote the sale of the Products in the Territory in accordance with the Principal's reasonable instructions and shall protect the Principal's interests *with the diligence of a responsible businessman.*"[3]

The same model contract resorts to another formula to qualify the agent's obligation to inform his principal:

> "The Agent shall exercise *due diligence* to keep the Principal informed about his activities, market conditions and the state of competition within the Territory. . . ."[4]

The scope of the duty to promote sales of the products is sometimes more specific:

- "SECUNDO shall use its best efforts to promote the sales of CONTRACT PRODUCTS, in particular by providing technical assistance for customers."
- "Le licencié s'engage à *faire ses meilleurs efforts* pour assurer le développement de son affaire de location de véhicules, sur le Territoire, sous la marque de commerce . . . , de manière à ce que le chiffre d'affaires de son affaire de location de véhicules sous la marque de commerce . . . se développe à un taux au moins égal à celui du marché de location de véhicules dans son ensemble, sur le Territoire."
- "L'agent s'engage à *faire ses meilleurs efforts* pour promouvoir *de la façon la plus active* la vente des Produits dans le Territoire.

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[3] I.C.C., Model Agency Contract, 1991, Art. 3.1.

[4] *Id.*, Art. 9.1.

"Ce faisant, l'Agent s'engage à ses frais à:
(i) servir la clientèle et gérer ses affaires afin de maintenir et développer l'image de marque attachée aux Produits;
(ii) solliciter *avec diligence* des commandes de Produits auprès des clients;
(iii) *mettre en oeuvre tous les moyens* commerciaux et administratifs *nécessaires* (y compris en personnel) pour *assurer* la promotion des Produits et la bonne exécution du présent Contrat;
(iv) *faire son affaire personnelle* de sa propre organisation, à savoir bureaux, personnel, déplacements, correspondance, etc . . . et à supporter directement toutes les charges y afférentes, en particulier en matière fiscale et sociale."

The last of these examples is particularly explicit. The first thing to note is that the expression "best efforts" is reinforced by the words "in the most active manner" and that the agent's duties are set out in detail. The scope of "best efforts" in this example is comparatively wide, although the details provided refer to other criteria that remain subject to interpretation ("diligently," "to use all necessary methods," "to take personal responsibility"). To refer to a distinction originated in French law, one could consider this to be reinforced "*obligations de moyens*" or even, in some cases, "*obligations de résultat.*"[5]

The following is an example of a clause providing for a negative requirement:

"The Agent will diligently and faithfully serve the Principal as its Agent and will use his best endeavours to promote the sale of the goods of the Principal within the Area and will not do anything that may prevent such sale or interfere with the development of the Principal's trade in the Area."

b. Construction Agreements

How does a building contractor undertake to complete the promised work? Often a contract will require that the work be performed with a given degree of care. For instance:

"The Contractor shall, *with due care and diligence,* design (to the extent provided for by the Contract), execute and complete the Works and remedy any defects therein in accordance with the provisions of the Contract. . . ."

[5] On these notions, now integrated into the Unidroit Principles, see *infra*, pp. 218–222.

This clause, which appeared in a FIDIC contract,[6] is very often used in other types of construction agreements; but what does "with due care and diligence" mean?

The following example seems more demanding:

"The contractor shall, commencing within days of the Effective Date of the Contract, proceed with utmost diligence and care in carrying out all of the Services specified as his obligations in the Contract. . . ."

In many cases, the term will be accompanied by a reference to business norms, as in this clause relating to the duties of an engineering consultant:

"The Consulting Engineer shall exercise all reasonable skill, care and diligence in the performance of the Services under the Agreement and shall carry out all his responsibilities in accordance with recognized professional standards."

A further example deals with the duties of an architect:

"In providing the service to the Client, the Architect shall exercise a reasonable standard of skill and diligence normally expected and accepted by the profession of architecture."

In French language texts, the corresponding provision will often refer to the "*règles de l'art*," i.e., to the accepted standards of the trade concerned:

"L'entrepreneur garantit que ses prestations, travaux et montage seront réalisés *selon les règles de l'art*, en conformité sur tous les plans avec les lois, les décrets, les règlements, les prescriptions et normes en vigueur en Tunisie lors de la signature du Marché."

The examples above define the general duties of contractors or other professionals in the construction industry. Other terms covering conduct are found in connection with more specific obligations.

In the following clauses, relating to the use of materials obtained locally, keeping the peace in the workplace and continuation of work in the event of war, the term "best efforts" is used:

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[6] *Conditions of Contract for Works of Civil Engineering Constructions*, 1987 ed., Part I, General Conditions, Art. 8.1. It will, however, be noted that the corresponding provisions of the most recent set of FIDIC contracts have eliminated this reference to the notion "*with due care and diligence*" in their description of the Contractor's obligations (*Conditions of Contract for Construction*, 1st ed., 1999, Art. 4.1; *Conditions of Contract for Plant and Design-Build*, 1st ed., 1999, Art. 4.1; *Conditions of Contract for EPC Turnkey Projects*, 1st ed., 1999, Art. 4.1).

> "With respect to any materials, supplies, goods, equipment or services purchased, leased, contracted for or otherwise obtained or required by the Contractor in the performance of the work, the Contractor shall use his best efforts to utilize materials, supplies, goods, equipment or services of Saudi Arabian origin or which may be obtained or acquired from entities organized under the laws of the Kingdom."

In this case, "best efforts" appears to involve at least several actions, which are defined and capable of proof, such as requests for local tender; on the other hand, if the fact of having contracted elsewhere can be justified by the lack of a given product in the local market, the provision becomes more difficult to construe if the alleged justification is linked to differences in waiting periods, quality, reliability, etc.

> "The Contractor shall at all times during the progress of the works take all requisite precautions and use his best endeavours to prevent any riotous or unlawful behaviour by or amongst his workmen, labourers and others employed on, or in connection with, the works, and for the preservation of the peace, protection of all inhabitants, and the security of property on or In the neighbourhood of the site."

Here, by contrast, the scope of the obligation appears *a priori* less clear. The required steps, to satisfy the obligation to use "best endeavors," will certainly depend on local circumstances.

> "If during the currency of the Contract there shall be an outbreak of war (whether war is declared or not) in any part of the world which whether financially or otherwise materially affects the execution of the Works, the Contractor shall until the Contract is terminated under the provisions in this clause contained use his best endeavours to complete the execution of the Works provided always that the Employer shall be entitled at any time after such outbreak of war to terminate this Contract by giving notice in writing to the Contractor and upon such notice being given this Contract shall terminate but without prejudice to the rights of. . . ."

This is not a *force majeure* clause, which would free the contractor from his obligation in case of war. Here he is required to continue the work, but the "best endeavors" clause in this case reduces the scope of the original obligation in view of the circumstances.

In the next case, pertaining to the preservation of access routes to the site concerned, the duty is to use "every reasonable means":

"The Contractor shall use every reasonable means to prevent any of the highways or bridges communicating with or on the routes to the Site from being damaged or Injured by any traffic of the Contractor or any of his Subcontractors and in particular shall select routes, choose and use vehicles and restrict and distribute loads that any such extraordinary traffic as will inevitably arise from the moving of plant and material from and to the Site shall be limited as far as reasonably possible and so that no unnecessary damage or injury may be occasioned to such highways and bridges."

The meaning of "reasonable means" here is clarified by a few examples and the objective to be attained is stated. In such a case, damage is without doubt considered inevitable and the contractor's duty is limited to doing what is "reasonably possible" in order to avoid all "unnecessary damage." It should be noted, however, that here again it is a question of "reasonable means" rather than "best endeavors." Do these two terms differ in scope?

c. Manufacturing of Materials and Parts for Motor Vehicles

In a contract between a car maker and firms producing materials and spare parts, the quality standard is set by references to the current state of science and technology, to safety regulations and certain agreeed technical data, as well as to the adoption of a quality management system:

"Der Lieferant hat für seine Lieferungen den Stand von Wissenschaft und Technik, die Sicherheitsvorschriften und die vereinbarten technischen Daten einzuhalten. Er muß ein entsprechendes Qualitätsmanagementsystem (z.B. DIN EN ISO 9000 ff., VDA-Schrift 6.1 o. ä.) einrichten und nachweisen."

d. Research Agreements

It is only too true that the popular maxim "seek and you shall find" does not apply to the legal obligations of a researcher. A research agreement requires research to be done, but there is no guarantee of its success. One author interprets the researcher's duty as a "sublimation" of an obligation of best efforts: not only can the results not be guaranteed, but the means cannot be defined and their use cannot be measured.[7] It is, however, possible to attempt to define the required depth of the research and terms of the "best efforts" type often appear in research agreements.

Below is a clause taken from the standard terms used by the West German Ministry of Defense in its research contracts with the private sector:

[7] Cl. Renard, Les contrats de recherche, in *Aspects juridiques de la recherche scientifique*, Liège and The Hague, 1965, pp. 47–49.

"Der Auftragnehmer kommt seinen Verpflichtungen zur Durchführung der Enwicklungsarbeiten nach, wenn er sich *nach besten Kräften* bemüht, unter Ausnutzung des neuesten Standes von Wissenschaft und Technik und unter Verwertung der eigenen Kenntnisse und Erfahrungen das bestmögliche Ergbnis zu erzielen."[8]

Here "best effort" is defined by the dual reference of taking into account the most up-to-date scientific development and using the researcher's own experience.

e. Technical Assistance Agreements

Technical assistance agreements require the provider of the assistance to carry out various duties, the scope of which is often measured by the yardstick of "best efforts" or some similar criterion. The quality of the results obtained does not, in fact, depend exclusively on the provider of the technical assistance; the beneficiary of the assistance must also be able to take advantage of what he has received. This concern is manifest in the following clause:

- "(Le donneur) ne peut cependant se porter garant ni de la productivité du personnel local, ni de la rentabilité de la Brasserie, et une insuffisance de productivité ou de rentabilité ne pourra servir de motif au non-paiement de la rémunération due (au donneur) en vertu du présent contrat, dans la mesure où aucune faute ne peut lui être imputée en application de l'alinéa qui précède."
- "(Le donneur) s'engage à exercer la mission qui lui est confiée *de manière consciencieuse* et répondra de toute faute que n'aurait pas commise un *professionnel normalement compétent et raisonnable.*

The qualifications in the first paragraph invite substantial comment. According to some interpreters, the words "in a conscientious manner" are not very demanding. To say that someone is a "conscientious" worker is certainly not to heap praise upon him. The reference to professional norms may go some way towards altering this impression, although the formulation does not appear to involve any particular stringency. The first paragraph, therefore, seems primarily to serve as an introduction to the second, which is the real nub of the clause.

In the next example, the accent is on the duty to use best efforts to pass on the techniques concerned, a duty considered to be "clear" since the provider's remuneration is partly linked to the turnover achieved. Does this wording not limit the liability of the party undertaking the duty to the loss

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[8] Cf. Cl. Witz & Th. M. Bopp, Best Efforts, Reasonable Care: considérations de droit allemand, *Rev. Dr. Aff. Int.*, 1988, p. 1036.

of his remuneration? The most explicit confirmation that the best efforts do not in any way amount to a guarantee of success appears in the following example:

> "While A cannot guarantee the technical success of the process, he obviously will make the best effort to provide the necessary technology available since A's compensation for the technology will he partially derived from a percentage of sales of N.C."

The provision of technical assistance may entail certain specific obligations, for example, the duty to carry out formalities necessary for any staff relocation:

> "Le Client fera *toutes les démarches nécessaires ou utiles* et déploiera *tous ses efforts* pour l'obtention en temps opportun de toutes les autorisations nécessaires pour permettre (i) au personnel local d'encadrement de suivre le programme de formation prévu en Europe, et (ii) aux agents de . . . d'effectuer leur mission, y compris non-limitativement l'obtention des visas pour ceux-ci et les membres de leur famille et les permis de travail."

In a clause such as this, does the undertaking to "use every effort" add to the undertaking to "take all necessary and useful action"?

The following example relates to a different matter. Here, it is the very duty itself to provide technical assistance that is qualified, and not the manner in which the assistance is to be provided:

> "*Dans la mesure de ses possibilités*, PRIMO fera également bénéficier SECUNDO de son assistance technique pour les études de parties mécaniques dont les caractéristiques techniques entreraient dans le cadre de l'annexe III.
>
> Les conditions dans lesquelles seraient entreprises ces études et la responsabilité incombant à PRIMO à ce titre seront définies cas par cas d'un commun accord."

This is close to an undertaking that is purely discretionary (and therefore without legal effect), except insofar as it might be held that a refusal to provide assistance may only flow from objective difficulties and is not entirely at PRIMO's sole discretion.

The following clause states a similarly weak duty:

> "ALPHA's team will do its best to try to introduce adjustments in the PLANT equipment, for the manufacture of such counts, with

the understanding that such counts having never been manufactured by ALPHA, ALPHA is not in a position to transmit any data and/or information relating to such production."

f. Trademark and Patent Licence Agreements

As in certain technical assistance agreements, clauses in licence agreements describing the manner in which techniques are to be passed on are sometimes combined with clauses seeking to limit or exempt from liability:

> "Whilst the Owner will take all reasonable care in giving the licensee the Owner's Formulae and Know-How and in laying down the Standards of Quality, the Owner accepts no responsibility in respect thereof or the plant used to manufacture the licensed Products or the production and distribution thereof and all guarantees or warranties (whether statutory express or implied) in connection therewith are hereby excluded and the Owner shall not be liable whether in contract, negligence or otherwise for any injury, damage, loss, costs, claims or expenses of any kind in any way attributable or alleged to be attributable to any of them."

In this example, the very wide and general nature of the exemption from liability (the validity of which would clearly be questionable under many legal systems) practically nullifies the whole effect of the duty to use "all reasonable care" in passing on the technology.

The same contract confers on each of the parties two specific obligations under the category "best efforts":

- "The Owner may further require that the Licensee . . . uses its best endeavours to recover any below standard products which have been previously distributed."
- "The Owner shall throughout the period of the Permission . . . use its best endeavours to ensure that no person to whom permission has been granted outside Benelux for the sale of the Licensed Products shall be permitted to advertise or promote,or otherwise seek customers for, the Licensed Products in Benelux or establish any warehousing, storage facilities or distribution or selling agencies for the Licensed Products in Benelux."

Insofar as the duty to recover defective products is concerned, it can be considered that, here, the expression "best endeavors" has a very definite scope. There are quite specific actions to be taken under such circumstances, and perhaps even a series of preventive measures that could be taken so that, if necessary, the retrieval procedure could commence

rapidly and efficiently so as to reduce as far as possible its prejudicial effects on the brand image of the product.

The duty to prevent competition between sellers in other territorial areas also involves certain concrete steps, beginning with the inclusion of clauses in the agreements forbidding export outside the area covered by the agreement (subject, of course, to problems with the validity of such undertakings in light of competition law).

g. Satellite Launch Agreements

In contracts under which they undertake to put satellites into orbit, both NASA and the European Space Agency use the concept of "best efforts" to qualify the scope of their obligations.

> "All Launch and Associated Services to be furnished by NASA to the User under this Agreement shall be furnished by NASA using its best efforts."

For such a type of especially risky transport contract, the classical obligation to reach the specific promised result is replaced by an obligation of best efforts.

However, it has been said by a NASA executive that the inclusion of this expression would have a more radical effect, namely of exempting the Agency from all liability:

"The concept of "best efforts" means that NASA and the customer agree that a legal action will not be brought against NASA or its contractors based on an express or implied provision of the LSA for damages or other relief for any delay in the provision of launch services, or for the non-performance or improper performance of launch service."[9]

This is a surprising conclusion. While in other circumstances,[10] the research group wondered if the effect of the reference to "best efforts" might be to reinforce the impact of the duty, one of the parties to the contract here appears to think that it amounts to an exemption from liability. Obviously a satellite launch is a very risky operation, and it is understandable that a party cannot take upon itself a very strict obligation. However,

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[9] Johan E. O'Brien, The Structuring of NASA Launch Contracts, Report to the Colloquium Organized in Paris, on December 5–6,. 1985, by the International Chamber of Commmerce, p. 5. Cf. also L. Ravillon, *Les télécommunications par satellites—Aspects juridiques*, Paris, Litec, 1997, pp. 209–213.

[10] See for instance *supra*, p. 196, concerning the recall of defective products.

we find such an assimilation between "best efforts" and exemption from liability debatable.[11] It is true that the simultaneous presence of certain exemption clauses in NASA contracts creates a further problem of interpretation; the existence of that problem prevented American courts from expressing a clear stand on the scope of the best efforts clause in itself.[12]

Supposing that NASA's interpretation was upheld, the validity of such an exemption from liability would be questionable under many legal systems, as it renders meaningless the obligations undertaken by the satellite-launching party.[13]

As a consequence of these difficulties, more recent NASA contracts tend to replace the notion of "best efforts" by a reference to "reasonable efforts."[14] The notion is probably more objective,[15] but ambiguities remain.

h. Letter of Comfort

A letter of comfort is intended to reassure a party, contracting with a subsidiary, of the support that the parent company is prepared to give its subsidiary in the event it encounters difficulties.[16] The letter will often be couched in fairly vague language, since the author will be seeking to avoid formulating precise obligations. Here is a typical example:

> "Nous n'avons pas coutume de garantir les crédits accordés à nos filiales.
> Cependant, de longue date notre politique est de maintenir notre soutien envers ces compagnies et de nous assurer qu'aucun établissement prêteur n'encourt de perte à la suite des relations d'affaires avec nos filiales quelle qu'en soit la cause. Cette politique sera suivie à votre égard quant à la ligne de crédit que vous accordez à notre filiale."

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[11] This opinion is shared by L. Ravillon, *op. cit.*, p. 210.

[12] Martin Marietta Corp. v. Intelstat, 991 F.2d 94, 97 (4th Cir. 1993), commented by L. Ravillon, *op. cit.*, pp. 211–212.

[13] Cf. *infra*, Chapter 7, and especially p. 385.

[14] L. Ravillon, *op. cit.*, pp. 214–215.

[15] Cf. *infra*, pp. 214–217.

[16] Cf. Faculté de Droit de Namur & Feduci, *Les lettres de patronage*, Namur and Paris, 1984; M. De Vita, La jurisprudence en matière de lettres d'intention. Etude analytique, *Gaz. Pal.*, 1987, pp. 667–670 (in spite of its deceptive title, this study deals with letters of comfort); M. Elland-Goldsmith, Comfort Letters in English Law and Practice, *Rev. Dr. Aff. Int.*, 1994, pp. 527–541; cf. also *supra*, Chapter 1, pp. 6–8.

Sometimes, however, a letter of comfort will go further:

> "If the Borrower is unable, for any reason, to effect any payment under such agreement when due, we shall use our best efforts in order to have funds available to the Borrower . . . by any appropriate means in amount sufficient to make any such payment."

Several members of the Working Group were of the opinion that in this case, the words "we shall use our best efforts" could be construed as an expectation of a very specific undertaking, approaching an "obligation to achieve a specific result." The author of the letter promises that the necessary funds will be made available if necessary. What is involved is a veiled guarantee of the debtor's obligations, except for the fact that funds will not be passed directly to the creditor but will be supplied to the subsidiary in order to allow it to meet its obligations itself.

Similar comments were made as to the undertaking expressed in the following letter of comfort to "do everything in its power":

> "La Société X, s'il en était besoin, ferait *tout ce qui serait en son pouvoir* pour mettre la Société Y en mesure d'assurer la bonne exécution des engangements pris par elle en ce qui concerne le remboursement des prêts prévus, tant pour le principal que pour le règlement des intérêts et accessoires."

In the above example, the interpretation of the wording is that the parent company pledges the necessary support to its subsidiary. The impact of the terms "best efforts" and "everything in its power" in this respect would, therefore, be very demanding.

Much case law has appeared on these problems, at least in France, with a variety of interpretations.[17]

i. Documentary Credit

The Uniform Customs and Practices for Documentary Credits make a stand against imprecise terminology. Thus, according to Article 46b of the 1993 edition:

> "Expressions such as 'prompt,' 'immediately,' 'as soon as possible,'and the like should not be used. If they are used banks will disregard them."

[17] Cf. the decisions cited by M. De Vita, *id.*, and, more recently, Cass. fr., Oct. 15. 1996, *Dall.*, 1997, J., 330; Paris, June 3 1997, *Dall.*, 1998, J., 5; Cass. fr., Jan. 26, 1999, *Dall.*, 1999, J., 577.

The same rules, though, incorporate such formulae when it comes to the verification obligations placed on bankers:

- "Art. 7 a. A Credit may be advised to a Beneficiary through another Bank (the "Advising Bank") without engagement on the part of the Advising Bank, but that bank, if it elects to advise the Credit, shall take *reasonable care* to check the apparent authenticity of the Credit which it advises. . . ."
- "Art. 13 a. Banks must examine all documents stipulated in the Credit *with reasonable care,* to ascertain whether or not they appear, on their face, to be in Compliance with the terms and conditions of the Credit. Compliance of the stipulated documents on their face with the terms and conditions of the Credit, shall be determined by international standard banking practice as reflected in these Articles. . . ."

What is "reasonable care"? The expression dates from the 1962 revision of the Uniform Customs and Practices. Before that, a bank was required to "carefully" examine the documents. Does the change in wording constitute a slight difference in the strictness of the bank's obligation? Does the word "reasonable" reduce the degree of care required?

j. Counter-Trade Agreements

In a counter-trade contract, the supplier under the principal contract undertakes, by a separate contract, to buy compensation goods for an amount equal to a certain percentage of the value of the principal contract. This undertaking to accept goods in counter-trade may be performed by a third party, but it is binding, as the usual inclusion of a penalty clause confirms.[18]

In the following example, however, the counter-trade obligation took on a restricted form:

> "Gegenstand dieses Übereinkommens ist der Gegenkauf tschechoslowakischer Ware in Zusammenhang mit dem Hauptvertrag. Firma A wird zum Gegenkauf jedenfalls *ihr Bestes* tun, um ihre Verpflichtungen zu erfüllen, wobei ins Auge gefasst ist, dass die folgenden Punkte von tschechoslowakischer Seite bevorzugt werden:
> "Maschinen und Anlagen von X, Prag,
> "Maschinen und Anlagen von Y, Prag,
> "Andere Maschinen,
> "Andere tschechoslowakische Güter."

[18] Cf. M. Fontaine, Aspects juridiques des contrats de compensation, *D.P.C.I.,* 1981, pp. 179–223.

This seemingly exceptional clause invites a variety of questions. What meaning can one read into the undertaking to "do one's best" in order to give some substance to the obligation? It should be noted that there is not even a clear statement of the amount of the required counter-trade, which increases the impression that this clause will hardly be enforceable. Could it not be said that the counter-trade obligation has been reduced to such a level that it resembles little more than some kind of brokerage undertaking, where there is a promise to devote "best efforts" to finding purchasers (compare the examples given above concerning sales promotion)?[19]

k. Acquisitions of Companies

According to a practice that has developed since the first edition of this book, the expression "due diligence" has come to be used with a particular meaning, in fact, a specific operation. Before acquiring shares in a company, the purchaser or his agents investigate the financial situation of the company at stake. This audit itself has come to be called "due diligence."

Here is a first example of a clause putting such an operation together:

> "Article 4. Diligence of (Company X). As of the Effective Date, Purchaser or Purchaser's representatives, counselors and officers shall have the right to inspect and examine the books and records pertaining thereto, and they shall have access to (Company X's) books and records, at all reasonable time during the Term, to the extent necessary for the proper performance of the due diligence and the application of the terms and conditions herein contained . . ."

Originally, "due diligence" was a qualification of the manner in which the purchaser had to run this inspection; the seller thus intended to protect himself against any later claims. But gradually, practicioners started to use the expression to define the investigation itself. One does the "due diligence" of such or such company.

This evolution had to be explained, since, for specialists in acquisitions, the expression "due diligence" means this type of inspection. Such meaning obviously goes outside the scope of the present study, which concerns the different ways in which contract drafters express the force of an obligation.

2. Types of Clauses

a. Duty of Confidentiality[20]

The duty of confidentiality frequently includes criteria of the "best efforts" kind. Here is a first example:

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[19] Cf. Cl. Witz & Th. M. Bopp, *op. cit.*, pp. 1036–1037.

[20] Confidentiality clauses are thoroughly examined *infra*, Chapter 5.

> "Visitor will use all reasonable efforts to prevent disclosure of any and all of Said Confidential Information furnished directly or indirectly by PRIMO to Visitor."

There is often a real difficulty in policing the respect for confidentiality clauses and the phrase "all reasonable efforts"; the present case may perhaps suggest a degree of resignation in anticipation of this.

It is, however, possible to be more precise; witness the following clause taken from a licence agreement:

> "Licensee shall for a period of ten years from and after the date of each disclosure hereunder, exercise all reasonable efforts to keep (Licensor)'s know-how disclosed In such disclosure secret and confidential. In fulfilling this operation, licensee shall use at least the same standard of care in safeguarding (Licensor)'s know-how from unauthorized disclosure as it uses in safeguarding its own confidential technical information and know-how."

The reference to the standard of care used by one party in the protection of its own information here enables the scope of "reasonable efforts" to be more clearly defined; it sets up a minimum standard ("at least"). One may still remain skeptical as to the efficacy of such clauses. The expression used allows the parties to reach agreement for now, but there will probably be difficulties later if a conflict arises.

b. "*Porte-Fort*" and "Good Offices"

- "Si PRIMO ou SECUNDO obtiennent d'un tiers une licence dans le domaine technique du présent accord, elles *s'efforceront* d'obtenir les mêmes droits aux mêmes conditions pour le partenaire du présent accord."
- "PRIMO s'engage à *faire tout ce qui est en son pouvoir* pour faire procurer à SECUNDO un montant de "x" millions de F pour couvrir une partie des besoins financiers qui seront nécessaires à l'exécution du plan industriel."
- "A undertakes to make all reasonable endeavours so that none of the companies from either the . . . Group of Companies or from . . . Group of Companies operating at . . . are deprived of their supplies of water, electricity, telephone or telex and it will use its best efforts to cause the necessary agreements for separate supply arrangements in respect of such supplies to the entered into by and between the relevant companies and/or the competent authorities as soon as possible."

The above are examples of three obligations to obtain undertakings from third parties, where the expressions used ("will endeavor to," "do everything in its power," "use its best efforts") seem to constitute commitments to appropriate means. Satisfactory performance of such undertakings will certainly involve carrying out certain minimum actions, but no guarantee of success is given. Under French law, it would be a question of a promise to use "*bons offices*" ("good offices") rather than a promise of "*porte-fort*" (an obligation to obtain an undertaking from a third party), where the promissor would normally be under a duty to achieve that result.[21]

The Group pondered the effect of the inclusion in the third clause of both "reasonable endeavors" and "best efforts." Do they suggest different degrees of duty? Or is it simply a question of the draftsman's concern to avoid repetition by choosing two expressions considered to be synonymous? Alternatively, should we be led to believe that the author of the clause was simply drafting without giving any particular attention to the terms he was using?

c. *Force Majeure* and Hardship Clauses

Force majeure clauses in international contracts often place a duty on one or both of the parties to attempt to overcome the obstacle concerned in order to allow the performance of the contract to be resumed.[22]

Here are two examples:

- ". . . parties shall exercise all due diligence to minimize the extent of the prevention or delay in the performance of the contract generally."
- "In case of *Unabwendbare Gewalt* (*force majeure*) the parties must make all reasonable efforts to eliminate or overcome the consequences of such an event. In this regard the parties shall work closely together and shall establish a new delivery plan within the limits of their possibilities. The parties are to keep the damages resulting from *Unabwendbare Gewalt* as small as possible and to take whatever measures are necessary in this regard."

The very nature of certain cases of *force majeure* prevents any absolute formulation of the duty to overcome the obstacle; very often it will not be possible (for example, the item to be delivered has been destroyed and

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[21] Cf. Ph. Malaurie & L. Aynes, *Droit civil. Les obligations*, 10th ed., 1999–2000, No. 683.

[22] Cf. *infra*, Chapter 8.

cannot be replaced, or a new regulation, which cannot be discarded, prevents performance of the contract, etc.). The obligation can, therefore, amount only to a duty of best efforts, but it may be expressed in different ways. Is "all due diligence" synonymous with "all reasonable efforts," or do the two expressions refer to different degrees of requirement? And what of a clause requiring a party to use its "best efforts" in the same circumstances?

A similar situation arises where the contract, on the occurrence of an event of *force majeure*, requires an alternative mode of performance. In the next example, it should be noted that the expression "all necessary steps" is clarified by an illustration of what this might involve:

> "The Seller and the Buyer will co-operate in order to obtain government approvals necessary to perform this Contract in any countries requiring such approvals.
>
> "Should for whatsoever reasons these approvals be denied or otherwise not obtained, the party responsible for obtaining such approvals will take all necessary steps to ensure the same result to the other party by changing the manner in which the transaction is consummated in such a way as to avoid the need for the government approval denied or delayed. Such steps may include the designation by the Buyer of a buying entity located outside of the countries where the companies included in the Stock are located."

"Reasonable efforts" has been replaced by "necessary steps," and the result is, probably, a higher degree of requirement.

A hardship clauses obliges the parties to enter into renegotiations when certain events occur that seriously affect the equilibrium of the contract.[23] Trying to find a new agreement requires mutual cooperation. Such requirement is phrased with a reference to "reasonable endeavors" in the following excerpt from a hardship clause:

> ". . . if in the course of this agreement unfairness to either of (the Parties) is anticipated or disclosed then the Parties will use *all reasonable endeavours* to agree upon and thereafter to take such action as may be necessary to remove the cause or causes thereof."

d. Obligation to Mitigate Losses

In the case of failure to perform a contractual obligation, current trends of the law of contract, greatly influenced by the concept of good faith, impose on the victim of the non-performance, the injured obligee, an obligation to mitigate his losses.[24]

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[23] On such clauses, cf. *infra*, Chapter 9.

[24] Cf. B. Hanotiau, Régime juridique et portée de l'obligation de modérer le dom-

Such a duty, where it arises, must be qualified. The reference to "reasonableness" often appears in as the measures to be taken.

> "Les parties s'efforceront de réaliser les objectifs qu'elles se sont proposés d'atteindre par le contrat. En particulier, la partie qui souffre de l'inexécution d'une obligation doit prendre toutes les *mesures raisonnables*, pour réduire au minimum le préjudice susceptible d'en résulter. Faute par elle d'agir de la sorte, elle ne peut obtenir de l'autre que la réparation du préjudice qu'elle ne pouvait éviter."

Provisions of this type appear in some international instruments:[25] The Vienna Convention on the International Sales of Goods refers to "such measures as are reasonable under the circumstances" (Article 77: see also Article 86). The measures to be taken must be "reasonable," but must also take account of the "circumstances," i.e., of the fact that an obligation is imposed on the injured party itself. "Reasonable," in this case has a restricted meaning.[26] The Unidroit Principles exonerate the obligor in default from indemnifying the harm ". . . to the extent that (it) could have been reduced by the (obligee)'s taking reasonable steps" (Article 7.4.8).[27] The same criterium of "reasonableness" appears, here without the additional reference to circumstances. The Comments to this provision state that "it would be unreasonable from the economic standpoint to permit an increase in harm which could have been reduced by the taking of reasonable steps." A dual reference to "reasonableness"!

B. Observations Concerning Practice

Two main conclusions may be drawn from the illustrations set out above.

1. The expressions used to define the quality of the performance required are varied, but can for the most part be grouped into several categories.
   The first category requires the obligor to provide the best he can: "best efforts," "best endeavors," "every effort," "everything in its

mage dans les ordres juridiques nationaux et le droit du commerce international, *I.B.L.J.*, 1987, pp. 393–405; M. Elland-Goldsmith, La "mitigation of damages" en droit anglais, *I.B.L.J.*, 1987, pp. 347–361; Y. Derains, L'obligation de minimiser le dommage dans la jurisprudence arbitrale, *I.B.L.J.*, 1987, pp. 375–382; S. Litvinoff, Damages, Mitigation and Good Faith, 73 *Tulane Law Rev.*, 1999, pp. 1161–1195.

[25] Cf. S. Reifegerste & G. Weiszberg, Obligation to Mitigate Loss and the Concept of "Reasonableness" in International Commercial Law," *I.B.L.J.*, 2004, pp. 181–197.

[26] On this provision, cf. C.M. Bianca & M.J. Bonell, *Commentary on the International Sales Law. The 1980 Vienna Sales Convention*, Milan, 1987, pp. 559–567 and pp. 620–624.

[27] A similar provision exists in the Principles of European Contract Law (Art. 9:505).

power," "to the best of its ability," "to the best of its experience," "the best it can," etc.

A second category refers to the criterion of "reasonableness": "all reasonable efforts," "all reasonable means," "reasonable care," "all reasonably possible efforts," etc.

A third category covers the concept of diligence: "with due diligence," "in a diligent manner," "with utmost diligence and care," etc.

A fourth category covers the recognized standards of the industry concerned: "*selon les règles de l'art*," "in accordance with recognized professional standards," "in accordance with good engineering practice," "*entsprechend dem Stand von Wissenschaft und Technik*," etc. These criteria are sometimes used in combination: "in every reasonable and proper way and to the best of his ability," "all reasonable skill, care and diligence," "with the diligence of a responsible businessman," etc.

2. The above examples are taken from contracts and clauses which, at first sight, appear varied. Among the duties defined by the relevant terms are in particular:

promotion of sales of a product in a defined market;
performance of construction works;
use of materials obtained locally;
ensuring good labor relations in the workplace;
continuation of work in the event of war;
carrying on research;
supply of technical assistance;
carrying out steps to obtain governmental authorizations:
withdrawal of defective products:
prevention of use of competing technology by third parties;
satellite launches;
guarantees of solvency of a subsidiary:
verification of conformity of documents;
purchase of counter-trade products;
protection of the confidential nature of certain information;
obtaining various commitments from third parties;
overcoming obstacles to performance of contractual obligations;
choosing and implementing measures aimed at restoring the equilibrium of the contract;
mitigating the damages flowing from a breach of contract.

Besides their variety, these duties, for the most part, share a common feature in that they all involve a degree of difficulty so that there can be no absolute guarantee that the desired result will be achieved. Sales may be developed, but to what extent? Work may be carried out, but doubtless it

will not be perfect. Research may be pursued, but it may never bear fruit. Attempts may be made to recall defective products, but it may be impossible to retrieve all of them. A substantial risk will remain that the satellite launch will fail, and so on. The party undertaking the duty thus cannot commit itself too strictly, but the contract will try to define a minimum degree of diligence with which it must comply: its "best efforts," "reasonable care," "due diligence," the "accepted standards of the relevant industry."

The list above, however, includes some anomalies. Some of the obligations listed do not involve the same degree of difficulty of performance as others. It is possible to pledge an absolute undertaking to guarantee the solvency of a subsidiary. The same applies to the purchase of counter-trade goods. We commented above that in spite of its formulation, the undertaking would have to be interpreted strictly (letter of comfort), or we pointed out the unusual nature of the obligation (counter-trade).

As to these anomalies, each of which demonstrates an attempt by one of the parties to restrict the normal scope of its obligation, the terms we have studied are not used in connection with undertakings that are generally capable of absolute performance (save where an outside exempting cause intervenes, such as *force majeure*, in the legal system recognizing this). Thus, one does not find clauses whereby one of the parties undertakes only to use "its best efforts" or "all reasonable care" to pay a price, royalties or rent, to hand over an item that has been sold, to transport goods or to return borrowed, hired or bailed property.

This study relates to undertakings whose successful performance cannot be ensured in advance. If no absolute promise of performance can be given, the expressions are used to define, to a greater or lesser degree, the intensity of the relevant party's obligation. It now remains to analyze these expressions.

III. ANALYSIS, ATTEMPT AT SYNTHESIS

A. Critical Analysis

Four main groups of terms are used to define the quality of an obligation: "best efforts," "reasonable efforts," "due diligence" and the relevant, accepted "trade" or "industry standards" (*règles de l'art*), with the many possible variations.

1. "Best Endeavours" and "Best Efforts"—English and American Interpretations

"*Meilleurs efforts*" and "*beste Kräfte*" appear in contracts in French and in German, but the expression "best efforts" seems to have originated in England or the United States. In both countries, a variety of judicial pro-

nouncements have been delivered in relation to the concept, the tendency being to prefer "best endeavors" in the England and "best efforts" in the United States.[28]

(a) Turning to English law,[29] the courts have sometimes been puzzled by the terms "best endeavors"; thus Goff J. said:

> "I ask myself, could anything be less specific or more uncertain? There is absolutely no criterion by which 'best endeavours' and practicability are to be judged."[30]

The same uncertainty appeared in another judgment:

> "Perhaps the words 'best endeavors' in a statute or contract mean something different from doing all that can reasonably be expected —although I cannot think what the difference might be."[31]

In general, however, the courts have tried to clarify the meaning to be given to the expression. The leading authority dates from 1911, and resulted from a case in which a railway company had undertaken to use its "best endeavors" to develop the business of another company. The judgment states:

> "We think 'best endeavours' means what the words say; they do not mean second-best endeavours. We quite agree with the argument of Mr Balfour Browne that they cannot be construed to mean that the Great Central must give half or any specific proportion of its trade to the Sheffield District. They do not mean that the Great Central must so conduct its business as to offend its traders and drive them to competing routes. They do not mean that the limits of reason must be overstepped with regard to the cost of the service: but short of these qualifications the words mean that the Great Central Company must, broadly speaking, leave no stone unturned to develop traffic on the Sheffield District line."[32]

Another contract contained a clause requiring a purchaser to use his "best endeavors" to obtain planning permission. Buckley L.J. said:

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[28] Compare the Romanian arbitral cases based on the former C.M.E.A. conditions, commented by O. Capatina, La clause "best efforts" dans les contrats conclus par les entreprises roumaines de commerce extérieur, *R.D.A.I.*, 1988, pp. 1044–1046.

[29] Part of the cases which will be mentioned are also commented by M.D. Varcoe-Cocks, Best Endeavours, *The Law Society's Gazette*, 1986, pp. 1992–1993.

[30] *Bower v. Bantam Investments Ltd*, (1972) 3 All E.R. 349, 355.

[31] *Oversea Buyers Ltd v. Granadex SA*, (1980) 2 Lloyd's Rep. 608.

[32] *Sheffield District Railway Co v. Great Central Railway Co*, (1911) 27 TLR 451.

> "I can feel no doubt that, in the absence of any context indicating to the contrary, this should be understood to mean that the purchaser is to do all he reasonably can to ensure that the planning permission is granted. If it were refused by the Local Planning Authority, and if an appeal to the Secretary of State would have a reasonable chance of success, it could not, in my opinion, be said that he had 'used his best endeavours' to obtain the planning permission if he failed to appeal . . . I cannot find . . . any context which satisfies me that the words 'use its best endeavours to obtain consent' could be construed otherwise than in accordance with what I take to be their clear, primary and natural meaning."[33]

A more precise formula appeared in a case where "best endeavors" were to be used in order to complete an acquisition by a certain date:

> "'Best endeavours' are something less than efforts which go beyond the bounds of reason, but are considerably more than casual and intermittent activities. There must at least be the doing of all that reasonable persons reasonably could do in the circumstances."[34]

Although some of these stances may be criticized as seeking to explain an uncertain concept by reference to another equally uncertain terms, the general attitude of the courts seems to be to give a particularly strict meaning to the undertaking to use one's best efforts: "'best endeavors' do not mean second-best endeavors."[35]

More recently, the House of Lords has recognized the legally binding character of an undertaking to use one's "best endeavors," at the same time as the House denied such character to an agreement to negotiate "in good faith."[36] The Court of Appeal has confirmed this position concerning "best endeavors."[37]

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[33] *IBM United Kingdom Ltd v. Rockware Glass Ltd,* (1980) FSR 335.

[34] *Pips (Leisure Productions) Ltd v. Walton,* (1980) 43 P & CR 415.

[35] However, an undertaking to exert one's "best endeavors" cannot be absolute; it must sometimes yield to other concerns. Thus, in a case where shares were to be transferred, the assignee company and its banks had undertaken to use their best endeavors to obtain the shareholders' approval. At that moment came a draft legislative modification which would have made the operation prejudicial to the assignee company. This company and its banks then made sure that the shareholders would not grant their approval. The tribunal admitted such conduct under the circumstances, in spite of the "best endeavors" clause (*Rackam v. Perk Food Ltd,* BCLC 1990).

[36] *Walford v. Miles* (1992) 2 AC 128.

[37] *Pitt v. PHH Asset Management Ltd* (1994) 1 WLR 327. We thank Professor M.P. Furmston, who drew our attention to the last two cases cited.

(b) American case law has also produced some interpretations of the twin concept of "best efforts."[38]

The Falstaff brewery had promised "to use its best efforts to promote and maintain a high volume of sales" of the products of the Ballantine brewery, having acquired a large number of Ballantine's assets and agreed to pay royalties on the sales achieved. Later, however, having suffered losses in connection with this activity, Falstaff decided to promote its own beer in preference to that of Ballantine, the result of which was that sales of the latter fell and, in consequence, so did the royalties.

The court held that Falstaff had breached its undertaking:

> "Although the best efforts clause did not require Falstaff to spend itself into bankruptcy to promote . . . Ballantine . . . it did prevent the application . . . of (a) philosophy of emphasizing profit über alles without fair consideration of the effect on Ballantine volume. [Ballantine] was not obliged to show just what steps Falstaff could reasonably have taken to maintain a high volume for Ballantine products. It was sufficient to show that Falstaff simply didn't care about Ballantine's volume. . . . The burden then shifted to Falstaff to prove there was nothing significant it could have done to promote Ballantine's sales that would not have been financially disastrous."[39]

One may note, in particular, from this judgment the court's interesting idea of allocating the burden of proof.

In other cases, the American courts have not had to interpret express "best efforts" clauses, but have found implied undertakings to use best efforts, and have also sought to define the concept.

The starting point is the decision in *Wood v. Lucy, Lady Duff Gordon*,[40] where Judge Cardozo found consideration for a right to demand royalties in the context of an exclusive agency agreement for fashion items, by virtue of an implied undertaking to use "reasonable" efforts to make the operation profitable. Later decisions have confirmed this interpretation by using, without distinction, the expressions "best efforts" and "reasonable efforts," which were considered to be interchangeable.[41]

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[38] Cf. also *supra*, pp. 197–198, about the particular case of satellite launching contracts.

[39] *Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609 (2d Cir. 1979).

[40] 222 N.Y. 88, 118 N.E. 214 (1917).

[41] Cf. *HLM Corp. v. General Foods Corp.*, 365 F.2d 77 (3d Cir. 1966); Lawrence S. Long, Best Efforts as Diligence Insurance: in Defense of "Profit Über Alles," 86 *Col. Law Rev.* (1986), p. 1728 and note 6.

A group of Catholic priests sold a manufacturer the exclusive rights to manufacture and distribute records of an opera that they had written, "Virgin." The contract required the manufacturer to spend$ 50,000 on promoting the work unless, "in the manufacturer's sole judgment, such promotion would cease to be effective and profitable." The promoter invoked this clause to justify ending all promotional activity. The court held that, in spite of the terms of the provision, the decision was not at the promoter's complete discretion. The promoter had assumed an implied obligation to use his "best efforts" to ensure the promotion of "Virgin," and the onus was on him to prove that he had not failed in this.[42]

In another case, an American judge took a less rigorous view of the words "best efforts." A Mr. Zilg had written a Marxist-inspired biography of the Du Pont family (*Du Pont: Behind the Nylon Curtain*), and Prentice-Hall had obtained exclusive rights to decide on the printing, sale price, style of publication and all aspects of its promotion. Following the extremely negative reaction of a book club, Prentice-Hall greatly reduced the print run and the publicity budget. In this case, the court held that in the absence of an express "best efforts" clause, the editor had adequately fulfilled his obligations by initially exerting appropriate efforts and then reducing them substantially on the basis of poor commercial prospects. In this case, the onus of proof of breach of the contract fell on the plaintiff, Zilg.[43]

The cases prompted some interesting commentaries in legal literature. Lawrence S. Long formulated three possible meanings of the term "best efforts": the most demanding placed on the party undertaking the obligation a "fiduciary duty" requiring it to subordinate its own interest to that of the party to whom it owed the duty. None of the decisions cited above supports this interpretation. At the other extreme, the interpretation referred to by the author as "diligence insurance" meant that the interests of the party undertaking the obligation was of primary importance; this party would bear no risk of liability except where its lack of effort went so far as to prejudice its own interests. This was the Zilg interpretation, where the publisher was not liable when it justified its cessation of efforts by claiming that it had little hope of making a profit. A midway position would require the interests of both of the parties to be taken into account, as in the Falstaff/Ballantine case or that of the religious opera. Long argued in favor of the "diligence insurance" interpretation, which he believed was the most effective in economic matters.[44]

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[42] *Contemporary Mission, Inc. v. Famous Music Corp.*, 557 F.2d 918 (2d Cir. 1977).

[43] *Zilg v. Prentice-Hall*, 717 F.2d 671 (2d Cir. 1983), *cert. denied*, 466 U.S. 938 (1984).

[44] Lawrence S. Long, *op. cit.*, pp. 1728–1740.

Farnsworth showed that the level of the duty imposed by the words "best efforts" can increase according to different criteria, which he drew from American case law.[45]

One possibility is for the party owing the duty and the party to whom the duty is owed to be considered as one. The question is then one of degree of care that such a person ought reasonably to have exercised in the given situation. This interpretation might, in particular, be sufficient to determine the level of effort required from an agent.

On the other hand, it may not be possible to consider the two parties as one, if the party undertaking the duty has been chosen by virtue of its special abilities, for example, a barrister or an architect. In such cases, "best efforts" are to be interpreted by reference to the reasonable care and level of competence that one would normally expect from a professional in that field.

Various difficulties arise when the two have opposing interests. Thus, a publisher who undertakes to use his best efforts to promote work whose prospects of success are slim, the author being paid by a commission on sales, would fall into this category. If we look to the reasonable behavior of a professional in a given field, we must accept that a publisher should be able to stop promoting a book, placing its own interests first (this is the Zilg reasoning mentioned above, after the initial promotional activity had failed). Another possibility in this case would be to return to the first interpretation and to consider the parties as one in order to take as the object of the "best efforts" the volume of sales that would maximize the combined profit of the partners.

Goetz and Scott are of this opinion in a remarkable study where they sought to identify the elements that characterize "relational contracts," i.e., contracts that bind the parties into a given relationship for a certain duration, the full evolution of which cannot be foreseen at the start.[46]

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[45] E.A. Farnsworth, On Trying to Keep One's Promises: The Duty of Best Efforts in Contract Law, 46 *Univ. of Pittsburgh Law Rev.* (1984), pp. 9–13; cf. also E.A. Farnsworth, *Contracts*, 2nd ed., vol. II, 1998, pp. 381–388.

[46] Cf. J. Goetz & R.E. Scott, Principles of Relational Contracts, 67 *Virginia Law Rev.* (1981), pp. 1089–1150. On this approach of contracts, also see I.R. Macneil, The Many Futures of Contracts, 47 *Southern Calif. Law Rev.* (1974), pp. 691–816; I. R. Macneil, Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical and Relational Contract Law, 72 *Northwestern Univ. Law Rev.* (1978), pp. 854–905; D. Campbell, The Social Theory of Relational Contract: Macneil as the Modern Proudhon, 18 *Int. J. of the Sociology of Law* (1990), pp. 75–95; A. Schwartz, Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies, 92 *The J. of Legal Studies* (1992), pp. 271–318; N. Nassar, *Sanctity of Contracts Revisited—A Study in the Theory and Practice of Long-Term International Commercial Transactions*, Martinus Nijhoff, 1995, 297 pp.; J. Oechsler, Wille und Vertrauen im privaten Austauschvertrag—Die Rezeption des

The allocation of risks cannot be dealt with in a precise manner at the time when the contract is concluded, so the contract will contain certain fairly indeterminate provisions. The level of obligations required may therefore be defined by the standard of "best efforts."[47]

However, the authors were concerned with the uncertainty of this term. They wrote:

> "Perhaps the most poorly understood class of relational contracts is that involving agreement wherein one party explicitly, or even implicitly, undertakes the contractual duty of using its "best efforts" to carry on an activity beneficial to the other. . . . The precise legal meaning to be attached to a best efforts requirement is not at all clear."[48]

By reference to a graphical analysis setting out the curves of marginal costs and marginal revenue,[49] Goetz and Scott suggested that the concept of "best efforts" amounted, for the distributor whom they were using as an illustration, to an obligation to achieve a volume, which could be gauged from the graph, where the combined profits of the two parties were maximized. This would be a plausible interpretation of the will of the majority of the parties to contracts, and a solution that complied with the demands of distributive justice.

Certainly, the authors continued, one could not expect a party undertaking a "best efforts" obligation to try to achieve this level of duty if it did not have adequate information as to its partner's accounts. Besides, enforcing such a requirement would entail strict policing procedures. We should not allow these reservations to make us lose sight of the effective extra-judicial role that the inclusion of such a duty can play, particularly in the field of commercial ethics:

Theorie des Relational Contract im deutschen Vertragsrecht in rechtsvergleichender Kritik, *RabelsZ. für ausl. und intern. Privatrecht*, 1996, pp. 91–124.

[47] In the words of N. Nassar, "Under the relational model, the goal of contract law is not limited to ensure enforceability, certainty and delimiting rights and duties. Rather, it is more concerned with establishing the boundaries and aims of the institution or practice of contracting. Contract law is there to provide for the continuity of relationships through resolution of conflicts and correcting for market changes and failures that may arise during the course of performance. Solutions adopted under contract law primarily should be concerned with furthering all the different interests involved. This is usually attainable through the articulation of legal standards which, contrary to technical rules, are inherently flexible. Fairness and good faith, defined in reference to best efforts, become the backbone of contract law through which mutual trust between the contracting parties is promoted" (N. Nassar, *op. cit.*, p. 24).

[48] Ch. J. Goetz & R.E. Scott, *op. cit.*, p. 1111.

[49] *Id.*, p. 1113.

> "Notwithstanding practical difficulties of securing legal enforcement, therefore, a contractual provision also has value simply as a communication of understanding between the parties as to their mutual rights and duties. Hence, the inclusion of a best efforts term may, at a minimum, serve as signal alerting good faith bargainers that the proposed contractual relationship is one in which special concerns are to be considered."[50]

The concept of "best efforts" has thus been the subject of various comments in the United States. The courts' approach has been guarded both as to the scope of the concept as well to evidential concerns flowing from it. At least three recent studies have analyzed the case law and suggested different interpretations. There is no unanimity but the analysis has been greatly refined: in one case, a graphic representation of the concept of "best efforts" has even been proposed.

2. *"Reasonable" in Common Law and Civil Law*

> "Reasonableness is indeed, we might all admit, a good thing in itself, even if, like moderation, good only within reason and in moderation. What is less clear, and certainly less easily agreed or settled, is what actually it is reasonable to do, to say, to conclude or to doubt in a given context."[51]

The concept of "reasonableness" is, however, widely used in law, particularly in common law,[52] although it is not unknown in certain civil law systems.[53] In some cases, the author of the legal rule (be it legislator or draftsman of a contract) will use the term "reasonable" to qualify a concept to unburden himself of the necessity of formulating a precise rule and leaving the resolution of any ensuing litigation to the ulterior interpretation by the courts, on this general criterion. In other cases, the court itself may take the initiative to determine what is reasonable when giving the motives for its decision ("it seems reasonable to believe").[54]

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[50] *Id.*, p. 1117.

[51] N. Mac Cormick, On Reasonableness, in *Les notions à contenu variable en droit*, Brussels, 1984, p. 131.

[52] Cf. G. Tixier, La règle de "reasonableness" dans la jurisprudence anglo-américaine, *Rev. Dr. Publ. Sc. Pol.*, 1956, pp. 276–298; V. Amar & Ph. R. Kimbrough, Esprit de géométrie, esprit de finesse, ou l'acception du mot "raisonnable" dans les contrats de droit privé américain, *D.P.C.I.*, 1983, pp. 43–56.

[53] Cf. R. Legros, L'invitation au raisonnable, *Rev. Rég. Dr.*, 1976, pp. 5–13; Ch. Perelman, Le raisonnable et le déraisonnable en droit, *Arch. Phil. Dr.*, 1976, pp. 35–42; G. Khairallah, Le "raisonnable" en droit privé français—Développements récents, *Rev. Trim. Dr. Civ.*, 1984, pp. 439–467. Compare the German concept of "Zumutbarkeit," refered to by Cl. Witz & Th. M. Bopp, *op. cit.*, pp. 1030, 1033.

[54] J.A. Salmon, Le concept de raisonnable en droit international privé, *Mélanges Reuter*, pp. 449–451.

Legislators frequently use the term. To cite but a few significant examples, in the United States, the Uniform Commercial Code refers to the concept of "reasonableness" in numerous provisions (see, for example, Sections 1-204, 2-305 and 2-309). The English Unfair Contract Terms Act 1977 also makes many such references (see in particular Articles 1(1), 2(2), 3(2), 4(1), 6(3), 7(3), etc.), and then goes on to devote a whole schedule to the definition of the term.[55] The 1980 Vienna Convention on International Sales of Goods includes innumerable references to the concept of "reasonableness" (see in particular Articles 8, 18, 25, 33, 34, 37, 38, 39, 43, 44, 46, 48, 49, 65, 72, 75, 77, 79, 86, 87 and 88). The definition of a defective product in the European Directive of July 25, 1985 refers to the "the use to which it could reasonably be expected that the product would be put" (Article 6). The Unidroit Principles of International Commercial Contracts also make entensive use of the "reasonable" standard (cf. Articles 1.8, 2.20, 3.5, 3.9, 4.1, 4.2, 5.2, 5.3, 5.4, 5.6, 5.7, 5.8, 6.1.1, 6.1.16, 6.1.17, 6.2.2, 6.2.3, 7.1.5, 7.1.6, 7.1.7, 7.2.2, 7.3.1, 7.3.2, 7.3.4, 7.3.6, 7.4.4, 7.4.5, 7.4.6, 7.4.8, 8.4 and 9.1.12). The same can be said about the Principles of European Contract Law.

The draftsmen of international contracts are no different. Besides numerous references to the word "reasonable" to define periods of time, events of justification, evidence required, etc., which are not within the scope of this study, the term frequently appears in relation to the mode of performance of obligations. We cited above many examples of the use of the words "reasonable care," "reasonable efforts," etc.

What does the word "reasonable" mean? Doubtless, it is necessary to distinguish between "reasonable" and "rational." "Reasonable" in the present context, does not mean "logical"; it does not mean conforming to "reason" in the philosophical sense, but conforming to "reason" in the practical sense—to common sense, to generally accepted value judgments.[56] This "practical reason" applies in situations where the standard of behavior required depends on taking into consideration and pondering a number of factors, the different circumstances capable of influencing the decision to be taken.[57] Thus, a carrier required to take "reasonable care" of goods must investigate methods of preservation and packaging such goods, how fragile they are, the transport risks that threaten them, etc.[58]

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[55] *Schedule 2: Guidelines for application of Reasonableness Test.*

[56] J.A. Salmon, *op. cit.*, pp. 447–448; compare G. Khairallah, *op. cit.*, pp. 456–460.

[57] N. Mac Cormick, *op. cit.*, p. 136. *Schedule 2,* attached to the English *Unfair Contract Terms Act,* gives a list of different factors to consider in order to determine the reasonableness of a contractual clause.

[58] G. Khairallah, *op. cit.*, p. 464.

The person who takes good decisions is the "reasonable man," similar without doubt to the French "*bon père de famille*," a concept derived from the venerable "*bonus paterfamilias*."[59] The way in which a contracting party behaves and the interpretation of the concept of "reasonable care" or "reasonable efforts" is measured by reference to the actions of this reasonable man.

We have, however, still not given any definitions. How do you define the use of "practical reason"; how do you give a judicious evaluation of the different factors present? It is possible to list the typical actions of the "reasonable man,"[60] yet it is almost impossible to define him without being tautologous.

Reference is often made to behavior that is usual in the circumstances, "reasonable" being very closely connected to what is generally accepted in a given social context.[61] The requirement can be reinforced by the addition of references to the behavior of an "experienced" or "prudent" person, having concern for the interest of all the parties.[62] This, however,

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[59] Cf. S. David-Constant, Le bon père de famille et l'an 2000, *Journ. Trib.* (Brussels), 1982, pp. 152–153.

[60] This can be done with humour, as in the following description: "(The *Reasonable Man*) is one who invariably looks where he is going, and is careful to examine the immediate foreground before he executes a leap or bound; who neither star-gazes nor is lost in meditation when approaching trap-doors or the margin of a dock; who records in every case upon the counterfoils of cheques such ample details as are desirable, scrupulously substitutes the word "Order" for the word "Bearer," crosses the instrument "a/c Payee only," and registers the package in which it is despatched; who never mounts a moving omnibus, and does not alight from any car while the train is in motion; who investigates exhaustively the bona fides of every mendicant before distributing alms, and will inform himself of the history and habits of a dog before administering a caress; who believes no gossip, nor repeats it, without firm basis for believing it to be true; who never drives his ball till those in front of him have definitely vacated the putting-green which is his own objective; who never from one year's end to another makes an excessive demand upon his wife, his neighbours, his servants, his ox, or his ass; who in the way of business looks only for that narrow margin of profit which twelve men such as himself would reckon to be "fair," and contemplates his fellow-merchants, their agents, and their goods, with that degree of suspicion and distrust which the law deems admirable; who never swears, gambles, or loses his temper; who uses nothing except in moderation, and even while he flogs his child is meditating only on the golden mean. Devoid, in short, of any human weakness, with not one single saving vice, sans prejudice, procrastination, ill nature, avarice, and absence of mind, as careful for his own safety as he is for that of others, this excellent but odious character stands like a monument in our Courts of Justice, vainly appealing to his fellow-citizens to order their lives after his own example" (A.P. Herbert, *Uncommon Law*, pp. 3–4). The author goes on to point out that in all case law, "there is no single mention of a reasonable woman" (*id.*, p. 5).

[61] G. Tixier, *op. cit.*, pp. 282–283.

[62] Cf. *Stanolind Oil and Gas Corp. v. Sellers*, USCA, 1949, 174 F.2d 948, cited by V. Amar & Ph. R. Kimbrough, *op. cit.*, p. 52.

remains a circular definition: what is a "prudent" person? "Reasonable" does not mean "heroic"; it is not a question of sacrificing everything on the altar of duty. Although a certain degree of strictness is expected of this "reasonable man," how is that degree to be established?

The Working Group spent a considerable amount of discussion time trying to define the concept of "reasonable" diligence. Although we could not come up with any completely convincing definition, a way of distinguishing between the two expressions "reasonable efforts" and "best efforts" has been suggested. It seems that "reasonable efforts" may be more objective. It refers to what will generally be considered necessary to be done in similar circumstances. "Best efforts," on the other hand, will be interpreted by reference to the abilities of the person undertaking the duty itself, which makes this latter term more subjective.[63] In fact, the wording of clauses refers, on the one hand, to "all reasonable efforts" or "all reasonable means," and, on the other hand, when speaking of the person who owes the duty, to "its best efforts." Sometimes the two criteria seem complementary: the formulation "in every reasonable and proper way and to the best of its ability," far from being redundant, would combine both concepts, requiring of the person under the duty both that it do its best and that it conform to generally expected norms of behavior.

However, all generalizations are dangerous. Furthermore, we must remember that civil lawyers care in defining concepts and setting the boundaries of categories is far from being shared by common lawyers. In American case law, "reasonable efforts" and "best efforts" are considered to be inter-changeable;[64] and for an English judge, "best endeavors" are "all that reasonable persons reasonably could do."[65]

Finally, "reasonable" seems, in certain cases, to have a mitigating effect on terms to which it is applied. It is no longer a question of referring to what the reasonable man would generally do, but of accepting that, in view of the circumstances, one cannot ask too much of the party undertaking the duty. Such was the interpretation given above by the Working Group to the "reasonable efforts" required to safeguard confidential information (given the great difficulty of preventing leaks), and to the "reasonable measures" required for mitigating losses (bearing in mind that, after all, it is the other party in such cases that is in breach). This is an important shade of difference, given that even the reasonable man himself might, to some small degree, be a little less vigilant in certain circumstances while nevertheless remaining true to character.

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[63] See a similar opinion in Cl. Witz & Th. M. Bopp, *op. cit.*

[64] Cf. *supra*, pp. 210–214.

[65] Cf. *supra*, p. 209.

3. "Due Diligence," "All Diligence," Obligations to Appropriate Means

(a) The term "due diligence" is very frequently used in contracts alongside "best efforts" and "reasonable care" to qualify the type of performance expected of the person under the duty. An agent must "diligently" seek orders from his clients, a contractor must carry out the work "with due care and diligence," or "with reasonable skill, care and diligence," the parties must exercise "all due diligence" to mitigate the effects of an event of *force majeure.*

Here again, any attempt at definition runs into serious difficulties. It is impossible to define such concepts precisely, which are used for the very reason that it is not possible to be more precise, if not to avoid being more precise.

"Diligence," in French as in English, appears to imply no more than "efforts."[66] It is the fact of trying to do something. It may also suggest an element of speed ("to be diligent"). What is most important, however, is probably the definition of the degree of "diligence" required. When it must be "reasonable," we are thrown back to the earlier discussions of "reasonable efforts." When it is stated to be "due" diligence, it seems that the meaning of this expression is similar. "Due" means what we expect: is that not the behavior of the "reasonable man"? In another case described above, a contractor undertook to supply his services "with utmost diligence and care"; here the requirement was specifically reinforced: the "reasonable man" must make greater efforts than those that would normally be expected of him. Above all, however, we note that in every case, the formulations are abstract: they refer to the standard of care generally expected and not to that of the particular party under the duty. It is not asked to use "his diligence," as it was required to use "his best efforts." In the applications found by the Working Group, the term "diligence" was used with reference to a general standard of behavior, like the criterion of "reasonableness" examined above.[67]

We would therefore put "due diligence" with "reasonable efforts" in the category of abstract standards, in contrast with the more subjective connotations of "best efforts." Here again, however, care must be taken. We must not be overly systematic where reality is very fluid.

(b) For lawyers in the French system or certain similar systems, an obligation of "diligence" evokes the concept of an "undertaking to appro-

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[66] The same can probably be said about terms like "care" ou "*soins.*"

[67] Compare, formerly, Section 67–D, 2° the CMEA General conditions of supply: "The care generally taken in relationships of a given kind shall be taken into consideration as a criterion for determining fault" (cf. also Section 67–E, 3°) (O. Capatina, *op. cit.*, pp. 1044–1046).

priate means" ("*obligation de moyens*"). Above, in the commentaries that accompany the illustrations of contractual practice, several references were made to the distinction between such undertakings and "undertakings to achieve a promised result" (*obligations de résultat*). For some it is tempting to try and amalgamate several of the formulae examined above with these two types of duty.

The distinction is constantly used by lawyers in the French tradition.[68] It is based on the idea that in certain cases, a party will undertake to achieve a given result (a classic example would be the carrier who promises that goods will be delivered), whereas in other cases, a party will undertake only to act as a "good family man" with a view to achieving the result, but does not guarantee it (a classic example of this would be the doctor who undertakes to treat a patient, not to cure him). The distinction is of great practical interest. If the result is not achieved, a party who accepts an undertaking to achieve a specific result is, *prima facie*, in default, and the onus will be on it to try to establish justification, whereas in the case of an undertaking to appropriate means it will not be the party undertaking the obligation, but the party benefitting from it, who will bear the burden of proving that adequate means were not used with the degree of diligence required. The distinction relates, therefore, both to the scope of the duty and to the burden of proof in the case of default.

The characterization of a given obligation as an undertaking to appropriate means or to achieve a specific result will depend on various factors. Its wording may be decisive. When a party promises in absolute terms to do something, subject only to the possibility of establishing an outside ground of justification in the event that it fails, this reveals an "*obligation de résultat.*" On the other hand, an "*obligation de moyens*" will arise where a party undertakes "to use all diligence" in carrying out the duty promised. Where the wording of the contract is uncertain, it will be for the court to decide, by reference primarily to the degree of risk that threatens the success of the service promised. If it is a question of an obligation that normally ends in a positive result (for example, an undertaking to pay a price or deliver goods), the court will doubtless classify it as an undertaking to achieve a specific result. If performance would normally involve difficulties of a type such that success cannot be guaranteed (for example, defending a client in an action at law or bringing round a company with financial difficulties), it will be considered to be an undertaking to appropriate means.[69]

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[68] Conceived by Demogue, (*Traité des obligations*, V, Paris, 1948, No. 1237), it permitted to solve a long-lasting controversy about the respective scopes of Articles 1137 and 1147 of the Civil Code. Cf. J. Frossard, *La distinction des obligations de moyens et des obligations de résultat*, Paris, 1965; G. Viney & P. Joirdain, *Traité de droit civil*, vol. IV, *Les Obligations, La responsabilité, conditions*, Paris, 2nd ed., 1998, pp. 440–544.

[69] A thorough discussion of these problems under French law is found in G. Viney, *op. cit.*, pp. 641–651.

The two categories of obligations to appropriate means and undertakings to achieve a specific result are not sufficient to cover all of the situations that may arise. Beyond undertakings to achieve a specific result, legal literature has also defined a class of "guarantee obligations" (*obligations de garantie*), where the party accepting the obligation gives an absolute undertaking, without reserving any right later to set up a ground of justification.[70] On the other hand, freedom of contracts permits many other formulations, restricted or extended undertakings to appropriate means, undertakings to achieve a specific result similarly relaxed or reinforced, etc. Legislators themselves make use of shades of difference. The "good family man" is referred to in Article 1137 of the Napoleonic Code (relating to the safekeeping of objects), the text that was the basis for the development of the concept of obligations to appropriate means. The "good family man" similarly appears, *inter alia,* in Articles 1374 (relating to unauthorized management of another's affairs), 1728 (use of objects on hire) and 1880 (safekeeping of objects on loan). Article 1137, paragraph 2, however, states that "the scope of this duty will be greater or smaller under different contracts," and Article 1927, for example (keeping of objects on deposit), replaces the criterion of the "standard of care of the good family man" with that of the "same standard of care as (the bailee) would use in keeping his own property." Here, the normally objective nature of the undertaking as to appropriate means becomes slightly more subjective.[71]

Obligations to appropriate means and obligations to achieve a specific result, therefore, constitute no more than two basic categories. Nevertheless, lawyers in the French tradition very often refer to these two categories for the purpose of analysis.

How far does this French "tradition" extend? Certainly to Belgium. where these concepts are in constant use;[72] but they are also applied in other jurisdictions such as the Netherlands,[73] Italy,[74] Quebec[75] and Romania.[76]

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[70] Cf. B. Gross, *La notion d'obligation de garantie dans le droit des contrats,* Paris, 1964; J.L. Fagnart, Les obligations de garantie, *Mélanges Baugniet,* Brussels, 1976, pp. 233–262.

[71] Cf. H. De Page, *Traité élémentaire de droit civil belge,* V, 2nd ed., Brussels, 1975, No. 198 (but compare Article 1928, where the bailee's liability is reinforced in certain cases).

[72] Cf. H. De Page, *op. cit.,* II, 3rd ed., Brussels, 1964, No. 596; P. Van Ommeslaghe, Les obligations. Examen de jurisprudence 1974–1982, *Rev. Crit. Jur. B.,* 1986, pp. 215–217.

[73] J.D.A. Den Tonkelaar, *Resultaatsverbintenissen en inspanningsverbintenissen,* Zwolle, 1982; A.S. Hartkamp, *Verbintenissenrecht,* I, 8th ed., Zwolle, 1988, No. 184.

[74] L. Mengoni, Obbligazioni "di resultati" e obbligazioni "di mezzi," *Riv. Dir. Comm.,* 1954, pp. 185–209, 280–320, 365–396.

[75] Cf. P.A. Crepeau, *L'intensité de l'obligation juridique ou des obligations de diligence, de résultat et de garantie,* Centre de recherche en droit privé et comparé du Québec, 1989, 232 pp.

[76] E.A. Barasch, I. Filip & O. Capatina, Considérations sur la classification des oblig-

In some other civil law countries, the concepts of obligations to appropriate means and obligations to achieve a specific result are scarcely recognized. Under German law, they are not generally used, although a similar approach takes place with the comparison in the Civil Code (BGB) between the *Dienstvertrag* (service contract) (Sections 611–630) and the *Werkvertrag* (work contract) (Sections 631–651); in the first type of contract, a party undertakes to perform services, whereas in the second, the undertaking is to perform a definite type of work.[77] In their excellent introduction to comparative law, the German authors Zweigert and Kötz refer to the French distinction, but they appear to treat it as an isolated development.[78]

In common law, one would expect such concepts to be formally rejected. Is not contractual liability objective, free of any idea of fault, whereas in the case of an obligation to appropriate means, fault must be proved and in the case of an undertaking to achieve a specific result it will be presumed? In theory, Anglo-American law treats all contractual obligations as guarantees, non-performance of which will, of itself, amount to a breach of contract giving rise to liability for damages.[79]

Nevertheless, aside from all attempts to impose too rigid a set of rules to govern contractual liability, does not the distinction between obligations to appropriate means and obligations to achieve a specific result correspond to real-life experience, where certain undertakings involve too great a degree of difficulty and uncertainty to be the subject of unconditional undertakings promising success? In the common law countries as elsewhere, when it is not realistic to give a more strict undertaking, the party undertaking an obligation promises no more than to use "every diligence," or its "best efforts." Professor Farnsworth himself, who specifically compared the American law concept of "best efforts" to the French system of obligations to appropriate means, wrote that:

> "our common law counterpart of the French obligation to appropriate means is, of course, the duty of best efforts."[80]

The distinction between *obligations de moyens* and *obligations de résultat* has recently gained a significant international consecration with its inclusion in the Unidroit Principles. Article 5.4 makes an explicit distinction between a *duty to achieve a specific result and a duty of best efforts.* In the latter

ations civiles en obligations de résultat et en obligations de moyens (in Romanian), *Studii si cercetari juridice,* 1971, pp. 583–590; O. Capatina, *op. cit.*, pp. 1049–1050.

[77] Cf. Cl. Witz & Th. M. Bopp, *op. cit.*, p. 1035.

[78] K. Zweigert & H. Kötz, *An Introduction to Comparative Law,* trad. T. Weir, 3rd ed., Oxford, 1998, pp. 501–502.

[79] *Id.*, p. 503.

[80] E.A. Farnsworth, *op. cit.*, p. 4.

case, the obligor "is bound to make such efforts as would be made by a reasonable person of the same kind in the same circumstances." The very interesting Article 5.5 then attempts, for the first time in a codification, to define criteria to distinguish between those two types of obligations: such criteria are largely inspired by case law that had developed on the subject in France and in Belgium.[81]

The considerations above cannot lead to an over-simplified analysis. "Best efforts," "reasonable care" and "due diligence," as emphasized above, often refer to the performance of obligations whose success is not guaranteed, and in this respect they, in fact, contain elements of obligations to appropriate means. On the one hand, the distinction between *obligations de moyens* and *obligations de résultat* provides only two basic formulae that are capable of numerous variations and shades of difference. Furthermore, our investigation of contractual practice has shown that the phrases studied are used in a great variety of contexts, sometimes giving rise to other interpretations. We have also tried to distinguish subjective expressions of the "best efforts" type from objective ones of the "reasonable care" and "due diligence" type. Any amalgamations of the various expressions should, therefore, be approached with great caution.[82]

Nevertheless, the comparison cannot be avoided and the idea of obligations to appropriate means makes it easier to understand the concepts that are the subject of this study.[83]

4. References to Business Norms

The quality of the performance expected is sometimes characterized by reference to business norms.[84] An engineering consultant will undertake to provide his services "in accordance with recognized professional standards"; an architect will undertake to exercise a "reasonable standard of skill and diligence normally expected and accepted by the profession of architecture"; a contractor will undertake to carry out work according to "accepted industry standards"; the supplier of technical assistance will be responsible for any error that "a reasonable professional person with a nor-

[81] In French law, cf. G. Viney & P. Jourdain, *Traité de la responsabilité civile. Les conditions de la responsabilité*, Paris, 2nd ed., 1998, No. 536–555; in Belgian law, S. Stijns, P. Wery & D. Van Gerven, Chronique de jurisprudence. Les obligations: les sources (1985–1995), *Journ. Trib.* (Brussels), 1996, pp. 723–724.

[82] In Romanian law, the notion of *best efforts* is analysed as referring to a reinforced obligation as to appropriate means (cf. O. Capatina, *op. cit.*, pp. 1048–1050).

[83] Comp. J.M. Mousseron, *Technique contractuelle*, Paris, 2nd ed., 1999, No. 1085–1086.

[84] On the legal aspects of norms in general, cf. Commission Droit et vie des affaires de la Faculté de droit de Liège, *Le droit des normes professionnelles et techniques*, Brussels, Bruylant, 1985; A. Penneau, *Règles de l'art et normes techniques*, Paris, L.G.D.J., 1989.

mal degree of competence" would not have made.[85] Several examples have been given above.

These criteria seem to be more precise than previous ones, since they refer to requirements peculiar to the professional field in which the party undertaking them is involved.[86] It is no longer a question of the "reasonable man" but of a professional person qualified in the area in question. True, some of the formulae cited above do combine different terms, including "diligence" and "reasonable." Nevertheless, the particular factor that characterizes these clauses is the reference to professional qualification.

Obviously, it is expected that a professional person will act in a professional manner; that is why his services are engaged. A professional person is not an amateur; he can call on technical education, experience, adequately trained staff and the requisite information. If he undertakes to render a service in his professional capacity, clearly he must use these resources in carrying out his undertaking. No other meaning can be attributed to the requirement that he perform his duties "in accordance with recognized professional standards."

Expressions such as these are more precise, since their meaning can be established in a relatively objective way. Thus, the accepted industry standards that a contractor must meet can be found in the specialized literature, the standards set up by different organizations, the conditions of the contract for works, the building regulations, etc.[87] An example has been given of an explicit reference to such norms imposed on suppliers of materials and spare parts for motor vehicles.[88] In the event of litigation, it is obviously easier to determine the way in which a professional, qualified in the area concerned, ought to have acted than to decide merely how a "good family man" would have behaved.

There is, however, no radical difference. In considering the behavior of a "good family man," a "diligent man" or a "reasonable man," we cannot

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[85] On such references to professional standards in German law, cf. Cl. Witz & Th. M. Bopp, *op. cit.*, pp. 1031, 1034, 1038, 1040.

[86] It will be noticed that in the four examples just given, only one refers explicitly to the obligor's specific profession (the architect). There seems to be no doubt, however, that the "professional standards" applicable to the engineering consultant are those of its trade.

[87] Cf. M.A. Flamme, Agréer les entreprises ou agréer et contrôler les produits?, *L'entreprise et le droit*, 1981, p. 320; cf. also A. Penneau, La notion de règles de l'art dans le domaine de la construction, *Rev. Dr. Immob.*, 1988, pp. 407–417; M.A. Flamme & Ph. Flamme, *Le contrat d'entreprise, Quinze ans de jurisprudence (1975–1990)*, Brussels, 1991, pp. 42–43, 146.

[88] Cf. *supra*, p. 193.

stay resolutely on the fence. This imaginary figure is often put in the same situation as the party undertaking the duty,[89] which renders it similar to the professional person. Still, the expression does not possess the same demanding character.

A reference to business norms is not always in and of itself sufficiently precise when activities of varying technical levels are found in a given field. Are the "accepted industry standards" the same for a small contractor in the construction industry as for a company that undertakes to build a vast industrial complex? Obviously not. Certainly, the reference to these accepted industry standards will imply that it is a question of standards adapted to the particular type of work. However, for any particular job, the person commissioning the work can call on a more or less specialized contractor; if he chooses a less experienced company, which may offer a more attractive price, should the "professional standards" of the more qualified competitors still apply?

Such questions are highly relevant in the context of international contracts. If the "accepted industry standards" consist of all the standards applied in the industry concerned, they will nevertheless not be the same in every country. Take the case of a French businessman who undertakes to carry out building works in Indonesia according to "accepted industry standards"; are the rules to be applied those relating to the French, or to the Indonesian construction industry? The question is important in a technical context and also perhaps in a legal context, if the legal regime governing warranties is held to be part of the "accepted industry standards." Some members of the Working Group thought that there would be an unacceptable difference in the treatment of businessmen from different countries if each was required only to conform to its national standards, which might be more or less exacting; others, however, emphasized that the client, in choosing the contractor, weighs up carefully the level of technical expertise and the nature of the warranty that it could provide.

The conclusion to be drawn from the above is that a reference to professional standards is worth clarifying when there is a difference between the qualifications of the party undertaking the duty and the standards that the other party wishes to apply to the undertaking, or when there may be some doubt because of differences in standards from one area to another.[90]

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[89] H. De Page, *Traité élémentaire de droit civil belge*, II, 3rd ed., Brussels, 1964, No. 588; G. Viney, *op. cit.*, No. 462, 530.

[90] Considering the rapidity of technical progress, it is sometimes advisable to be precise about the moment at which the industry standards applicable to the promised performance are to be determined. May the obligor be satisfied with performing in conformity with the standards existing when the contract was concluded, or must performance be adapted to technical progress occurred since then? On these questions, cf. Cl. Witz & Th. M. Bopp, *op. cit.*, pp. 1039–1040.

In one example given above, the necessary clarification was provided: the "accepted industry standards" were to be interpreted according to the standards in force in Tunisia, the place of performance; but such clarification is often lacking.

B. Attempt at Synthesis

The nature of the subject makes it difficult to reach very systematic conclusions. Some guidelines may be stated, but subject to numerous qualifications.

Take the case in which the draftsmen of the contract seek to state adequately an obligation that one of the parties is prepared to undertake. It is to be a relatively complicated obligation; the party undertaking it cannot promise perfect results.

In what way is that party to work? Efforts can be more or less intensive and the draftsmen will seek to state the degree of effort required. On this occasion, the dialectic of negotiations will oppose the beneficiary of the obligation, trying to express exacting requirements, and the party undertaking the obligation, concerned about not being placed under too strict a duty. The formula adopted will be governed by the negotiating skills and bargaining power of each—assuming that each is really aware of the impact of the choice of words.

1. Basic Citeria

(a) One way is to look at the degree of effort of which the party undertaking the obligation is capable. It may be required to do its best or to use its best efforts. The party benefiting from the duty knows its partner and expects it to use all its abilities in its service. This subjective criterion implies, in particular, that less is required of a small enterprise retained to perform a job than of a highly specialized partner. The party undertaking the duty agrees to use its abilities to their best effect to carry out the promised work. It is, however, still an exacting requirement: the party undertaking the duty must use its best efforts.

One may further wonder, whether what is required are the best efforts of which that party is capable or those that it uses to carry on its own business. Certain clauses use the latter criterion. Sometimes it constitutes a concession, where the intention is not to require a level of duty greater than that which the party concerned would use on its own account[91]: but it is often used to increase the duty, based on the observation that that party takes great care in its own affairs.

[91] In this line, perhaps, cf. Article 1927 of the Napoleonic Civil Code (cf. *supra*, p. 220), with regard to keeping of objects in deposit.

(b) A different formulation takes account of what is normally expected of a party undertaking an obligation of this type, who performs its obligation properly: "due diligence," "reasonable efforts" or, following the old Roman formula, the care of the "*bonus pater familias*." The term takes a turn for the abstract; it is no longer a question of referring to the competence of the contracting party itself; it is required to act in the manner generally expected of a diligent person in the same circumstances. This approach is, in itself, neither more nor less demanding than the previous one, rather it moves onto a different plane. "Normal behavior" is a sort of average, difficult for a party lacking in resources to achieve but well within the capacity of a sophisticated party.

(c) The third possibility is to refer to normal professional standards. The party undertaking the duty is required to exercise the degree of competence expected of a specialist in its field. The duty must be performed in accordance with "accepted industry standards," in the manner of a "reasonable professional person of a normal degree of competence." At first sight, this approach is midway between the two set out above—the general standards of the diligent and reasonable man and the standards of the contracting party itself. In fact what is really involved is a more precise version of the abstract approach. The "reasonable man" here becomes the "reasonable professional man." As we said earlier, the difference is only in the degree of precision given, since whether behavior is "reasonable" is determined by placing the "abstract" man in the same circumstances as the party under the duty, i.e., in his professional role.

2. *Shades of Meaning*

These few considerations show the main types of criteria that may be used to define the expected quality of a contracting party's obligations. Caution is required, however, when, in any particular case, the contractual terms have to be interpreted.

(a) An investigation of the actual circumstances in which a clause was inserted in the contract can lead to different conclusions.

- It is manifestly true that some of the expressions examined above are not always used by the draftsmen in contracts in full knowledge of the consequences of their choice of terminology. Negotiators do not always think twice before undertaking in "a reasonable manner." Such terms sound reassuring and inoffensive. Some of the members of the Working Group suggested that their inclusion in a contract would appear to give it a "friendly" or "convivial" air. In such circumstances, it would be quite preposterous, in interpreting such a clause, to try and discover the will of the parties.

- In other cases, the choice of terminology is the result of the negotiators' inability to agree on more precise wording to express the obligation undertaken. A solution is found in the adoption of supposedly vague wording (for example, "with care," "its best . . ."), which, when litigation later ensues, simply postpones the difficulty. Here again, if the basis for interpreting the term is to be the will of the parties, it will not be found by examining the meaning of the words.
- Sometimes, on the contrary, great consideration is given to the choice of phraseology but, in the mind of one of the parties at least, the words chosen mean something different from what one would expect on the basis of the interpretation set out above. The typical case is where a "best efforts" clause is used by a space agency to express a purported exemption from liability. Interpretation of such situations is very delicate; it will depend on knowing whether the other party was informed that this was the meaning intended and whether that party agreed with it, and will further depend on principles governing interpretation in general (see below). Moreover, the validity of such an exemption clause may be questionable.
- In another situation, wording is chosen without anything appearing to give it a meaning different from that set out above, but it relates to a duty in the performance of which a different degree of care is usually expected. Thus, a parent company may undertake to use its "best efforts" to ensure that its subsidiary is in a position to meet its obligations. An interpretation based on the nature and object of this duty might lead one to attribute a greater degree of severity to this expression than the wording actually implies. In this case, a letter of comfort, the Working Group thought that the "best efforts" amounted to an undertaking to achieve a specific result by the parent company. Such interpretation is, of course, open to question.
- A given term may sometimes have a particular meaning; in one situation described above, "reasonable" has been interpreted to mean "mitigating" or "reducing" the intensity of the obligation.
- Finally it should be recalled that these various expressions are often used in combination.

(b) On the other hand, in this area more than in any other, one must always bear in mind the specific features of the different legal systems and the principles that govern the interpretation of contracts.

- There are oppositing views concerning the grounds for contractual liability. Under common law, a contractual obligation is, in theory, absolute; under civil law, liability for breach will, in principle, only

arise on the basis of fault. The various clauses studied above require an examination of the conduct that has led to the disgruntlement of the party benefitting from the undertaking. They fit easily into the civil law structure, but under common law, in spite of the frequency with which they occur, they alter the normal system of liability.

- Whatever may be the general philosophy of its particular system of liability, each legal system may have its default solutions dealing with the degree of burden normally attached to such or such an obligation. In the absence of any qualification in the contract, rules exist everywhere (specific or based on general principles) for establishing the liability of a contractor in the construction industry, a licensor, a party involved in launching satellites. Every qualification used in the agreement must thus be interpreted by reference to the system that would apply in its absence.
- The interpretation of contracts under certain systems of law relies principally on finding the will of the parties. Particularly noteworthy in this context are Article 1156 of the French Civil Code and Article 1362 of the Italian Civil Code. Another tendency is to give preference to the expressed will of the parties as opposed to their actual will. German law, in this respect, falls between these two approaches. Under English law, although the matter is debated less than on the Continent, the expressed will of the parties is paramount: a clause whose meaning is clear does not need to be interpreted in accordance to the outside elements.[92] This was clearly illustrated in two statements by English judges, already cited above:
  - "*We think* 'best endeavours' *means what the words say* . . .";
  - "*I cannot find . . . any context which satisfies me that the words* "use its best endeavours to obtain consent" *could be construed otherwise than in accordance with what I take to be their clear, primary and natural meaning.*"

  These opposite approaches will clearly have a profound influence on the interpretation of the different expressions being considered, according to the applicable law. A legal system, which gives preference to the expressed will of the parties, will give the expression concerned a more literal meaning than a system of law that seeks to discover the actual will of the parties, beyond the language of their agreement.
- However, in practice, it seems that the English and American courts do not draw a distinction between "best efforts" and "reasonable efforts," whereas a literal interpretation might justify different meanings similar to those suggested above.

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[92] Cf. also *supra*, pp. 89 and 105–119; K. Zweigert & H. Kötz, *op. cit.*, II, pp. 406–409; C. Del Marmol & L. Matray, L'importance et l'interprétation du contrat, *Rev. Dr. Int. Dr. Comp.*, 1980, pp. 158–208.

- Several of the expressions discussed here are rarely used in certain legal systems (for example, "best efforts" in French law, in spite of the extent to which the expression has in practice come to be used in contracts), whereas they may be in common use in other legal systems where they have been examined in case law and in theoretical commentaries (for example, "best endeavors" and "best efforts" in English and American case law, and in American literature). The common lawyers' immoderate tendency to use the term "reasonable," which for them is really a familiar concept, is well known, whereas on the Continent, the term is used much less extensively. Besides, a given formulation may prompt certain lawyers instinctively to look to distinctions peculiar to their own legal systems (for example, obligations to appropriate means and to achieve a specific result for lawyers trained in French law or a similar system), whereas, *a priori*, the words may mean nothing under the other contracting party's legal system. Such situations may lead to misunderstandings: a clause that is vague or harmless for one party may be enormously significant for the other.
- The concept of "best efforts," in particular, has been greatly refined in American law, with the aid of economic analysis. Several levels of requirements have been suggested in order to clarify the exact meaning of the words; first, extending as far as interests of the party itself undertaking the obligation (the "diligence insurance" referred to above—a very restrictive interpretation); second, seeking the optimum combined level of satisfaction for both parties; and finally, requiring that the party concerned go so far as to sacrifice everything to the interests of the beneficiary of the duty (the "fiduciary duty" mentioned above).

IV. ADVICE TO NEGOTIATORS

The inclusion in a contract of a "best efforts," "reasonable efforts," "due diligence" "accepted industry standards" or similar kind of clause should not be taken lightly, in spite of the reassuring appearance of most expressions of this type. Various pieces of advice and warnings are prompted by the explanations above. The most important ones are:

1. Each of these terms, to varying degrees, acts to limit the extent of the duty undertaken by a given party to the contract, by comparison with an unconditional undertaking to carry out a totally satisfactory service. The interests of the beneficiary of such a duty are better served by a clause free of any qualification of this type. However, where complete success of an action cannot be guaranteed, the inclusion of such terminology becomes inevitable.
2. In the first place, before suggesting any wording, it is advisable to ascertain the standards by which the actions of the party con-

cerned will be measured: the usual behavior of the contracting party, how the party acts on its best days, how a professional of average competence in the area concerned, or a professional highly qualified in that area, would act; or there again, the general standard of a reasonable and careful man. The terminology must be chosen by reference to the desired level of requirement, whereas, too often, it is only later that the meaning of an expression chosen lightly is called into question.

3. The most precisely drafted clause prevents the most difficulties. In this respect, a reference to professional standards seems preferable to more general references (e.g., "reasonable efforts," "due diligence," etc.). Where necessary, the level of professional competence expected should be stated, if there are several different levels in the field concerned. It is often a useful technique to clarify by the use of a few examples the type of behavior expected of the party undertaking the duty. A couple of illustrations are set out above.
4. It Is important not to lose sight of the law applicable to the contract. The impact of a clause will vary according to the system of liability applicable under that law. Moreover, certain formulations have developed meaning under certain legal systems: negotiators obviously need to be aware of such meanings before selecting a clause, as seen above. The negotiators must also pay attention to the principles that will govern the interpretation of their chosen clause if difficulties arise.

Reference to expressions of "best efforts," "due diligence," "reasonable care" or "accepted industry standards" types, so frequent in international contracts, illustrates the dilemma between the impossibility for a contracting party to undertake certain obligations in absolute terms and the need to define the degree of requirement that the performance by the party undertaking the obligation must nevertheless fulfill. The drafting of such clauses is a delicate matter; no formula can ensure complete security. The above discussion will hopefully be of assistance in drafting the most appropriate contractual provisions with more lucidity. It is then up to the negotiators to use their best efforts!

CHAPTER 5
CONFIDENTIALITY CLAUSES IN INTERNATIONAL CONTRACTS

I. INTRODUCTION

King Midas, the judge of musical contest, was so imprudent as to prefer Pan's flute to Apollo's lyre. In revenge Apollo gave the King a magnificent pair of ass's ears. Midas, being ashamed, tried to hide them under his crown, but what should he do about his barber to whom disclosure was unavoidable? The King made him subscribe a confidentiality clause: nothing was to be revealed about the peculiarity of the royal ears. Unable to bear the weight of such a secret, the barber dug a hole in the earth and whispered into it what he knew, before re-filling the hole. But shortly afterwards some reeds grew at this spot that murmured to the wind: "King Midas has the ears of an ass"! The unfortunate King, whose secret was thus discovered, committed suicide by drinking the blood of a bull.

In our times, confidentiality clauses and secrecy agreements are widespread. It is no longer a matter of hiding ass's ears but technical processes, commercial methods, financial information. Exclusive information has economic value that is often substantial for the person holding it. In many circumstances, however, it has to be shared. The bearer may be tempted to extract an additional benefit by disclosing it to others. He sometimes must make certain disclosures to third parties in order to enable them to judge the value of a proposed operation. The specialization of work leads to the sharing of secrets with colleagues, employees, suppliers and sub-contractors. In all these cases, precautions must be taken so that the secret remains confined within strict limits to avoid its dilution and devaluation.

In the absence of any agreement, the law provides protection for certain confidential information. A "professional secret," which may be enforced by criminal law, exists in certain professions. Criminal law often also protects industrial secrets. Civil law imposes an obligation to be discrete, with contractual or at least delictual remedies. In many countries, and particularly in common law jurisdictions, extensive case law exists on these matters. Specific studies, made by certain members of the Working Group, have been published following the original publication of this

study, concerning the situation in Germany, England, Belgium, the United States and Romania.[1]

The applicable law does not always provide sufficient protection appropriate under the circumstances of the case, and, in many instances, practitioners prepare specific confidentiality agreements that they require from those to whom the information is to be revealed.

The Working Group has also come across such clauses in an incidental way while studying letters of intent, best endeavors obligations and obligations surviving a contract.[2] Their frequency, their significance and their complexity justify that they be the subject of a separate analysis. We present here the result of a study of a collection that included more than 250 clauses.[3]

In order to concentrate on the problem of confidentiality itself, a subject already sufficiently large, the present chapter will not consider two related concerns that often appear in the context of confidentiality clauses.

The first of these problems is that of the use to which confidential information may be put. There is often a close connection between the

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[1] O. Capatina, Remarques sur les clauses de confidentialité en droit roumain des contrats internationaux, *Rev. Dr. Aff. Int.*, 1991, pp. 107–134; P. Ellington, Obligations of Confidentiality—English Law, *Rev. Dr. Aff. Int.*, 1991, pp. 141–148; R. Jillson, Noncontractual Protection under American Law of Business Information, *Rev. Dr. Aff. Int.*, 1991, pp. 149–152; W. Kraft, L'obligation de confidentialité en droit allemand, *Rev. Dr. Aff. Int.*, 1991, pp. 135–140; M. Vanwijck & M.F. De Pover, La fonction protectrice du droit belge en matière d'obligations de secret et de discrétion dans les relations contractuelles en l'absence de clause de confidentialité, *Rev. Dr. Aff. Int.*, 1991, pp. 95–106. Legal literature is abundant on the subject; also see, e.g., Chr. Gavalda, Le secret des affaires, *Mélanges Savatier*, 1965, pp. 291–316; Travaux de l'Association H. Capitant, T. XV, *Le secret et le droit*, 1974; G.J. Virassamy, Les limites à l'information sur les affaires d'une entreprise, *Rev. Trim. Dr. Comm.*, 1988, pp. 179–217; A. Kohl, Les notes internes du juriste d'entreprise peuvent-elles bénéficier de la confidentialité accordée aux membres du Barreau?, *Cah. Dr. Eur.*, 1989, pp. 179–223; J. Huet & F. Toubol, Violation de la confidentialité des négociations, in International Chamber of Commerce, *Formation of Contracts and Precontractual Liability*, Paris, 1990, pp. 239–257; B. Bouloc, Le secret des affaires, *Dr. Prat. Comm. Int.*, 1990, pp. 6–41; B. Mercadal, *Mémento pratique de Droit des affaires*, 1990, pp. 450–451; Ph. Marchandise, Confidentiality Agreement, A Real Commitment!, *I.B.L.J.*, 2002, pp. 741–748.

[2] Cf. *supra*, Chapters 1, and 4, and *infra*, Chapter 13.

[3] On confidentiality clauses, also see Y. Poullet, Le marché de l'information. Aspects contractuels: les clauses de confidentialité, *Rev. Dr. Aff. Int.*, 1989, pp. 939–975; H. Dubout, Les engagements de confidentialité dans les opérations d'acquisition d'entreprises, *Bulletin Joly*, 1992, pp. 722–728; L. Ravillon, *Les télécommunications par satellite—Aspects juridiques*, Paris, 1997, pp. 475–480; J.M. Mousseron, *Technique contractuelle*, Paris, 2nd ed., 1999, No. 1156–1159; M. Bühler, Les clauses de confidentialité dans les contrats internationaux, *Rev. Dr. Aff. Int.*, 2001, pp. 359–387.

obligation of confidentiality and the permitted use. It certainly happens that the information finds its way to persons who have no right to use it, for example to an expert appointed to judge the value of a formula and to report on it,[4] but more frequently the information is provided so that it may be used, and the confidentiality clause often contains provisions as to how the information can be used. The two aspects are nevertheless distinct, and their effect differs upon the expiry of the contract. Normally the right to use comes to an end at that moment, while the obligation of confidentiality continues. The contract often prohibits the continued use of the knowledge, which may form part of a non-competition clause. This question would justify its own analysis, but we shall not undertake that in the present study. Nevertheless, we shall return to this parallel relationship between confidentiality and non-use when we examine the validity of secrecy clauses.[5]

The second question is that of the ownership of the information. Draftsmen sometimes choose to place within a confidentiality clause a declaration that the revelation of information to one's partner in no way implies the transfer of any right—other than that of temporary use—to that information. This phenomenon occurs frequently in agreements reached during the preliminary negotiations to licence contracts. Despite the insertion of such provisions in undertakings of confidentiality, the subject appears at a different level and we shall not concern ourselves with it.

A study of aspects of practice, with detailed analysis of confidentiality clauses in their different elements (Section II), will be followed by a series of general remarks and critical observations (Section III) before offering advice to negotiators (Section IV).

II. PRACTICE

A. General Remarks

Confidentiality undertakings come in various forms. They appear most frequently in certain types of contracts. They are often established at the negotiating stage, to appear again in the contract itself, which they frequently survive. The obligations created are unilateral, bilateral or parallel. These different aspects will now be examined in turn.

1. Form of Confidentiality Undertakings

(a) Confidentiality undertakings sometimes take the form of clauses inserted in contracts and sometimes become distinct contracts.

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[4] Cf. *infra*, pp. 294–295.

[5] Cf. *infra*, pp. 291–293.

Recourse to a specific agreement is particularly frequent in two sets of circumstances. At times, parties undertake negotiations prior to an intended future agreement, relating, for example, to the transfer of technology or the acquisition of shares. Information must be provided in order to permit one's partner to judge the value of the proposed transaction. Since, at this stage, no contract exists yet, it is natural to envisage a specific confidentiality commitment. Or, a party receives contractually confidential data, with permission to transmit it to others who will participate in their implementation, for example, employees or sub-contractors; the clause in the contract imposes a requirement to obtain a specific undertaking to secrecy by the third parties receiving the information.

Nothing, however, is clear-cut. It happens, too, that negotiators provide confidentiality obligations in the form of clauses contained within a preliminary agreement with a broader object, such as a letter of intent.[6] Secrecy obligations from employees are sometimes set out in their employment contracts.[7] Conversely, between parties to an agreement, the confidentiality of certain information may be judged so important as to give rise to an ancillary contract separate from the main contract.

(b) Whether it concerns a clause in a contract or a specific agreement, the length of confidentiality obligations is extremely variable. At one extreme, there is the simple note "confidential" placed on the document; at the other, the agreement is a dozen pages long. The majority of clauses are quite elaborate[8]; a minimum of several lines is necessary if one wants to cover, even briefly, the various aspects: the subject matter of the confidentiality, the exceptions to secrecy as to information and persons, the intensity of the obligation, its duration and the possible remedies. Not all the clauses in the sample are beyond criticism, far from it, but it is noticeable that the confidentiality provisions are often more carefully crafted than other clauses of the contract.

2. *Types of Contract*

Confidentiality undertakings are to be found in a great variety of contractual (or pre-contractual) situations.[9]

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[6] See an example *supra*, Chapter 1, pp. 25–26 and 46.

[7] Cf. *infra*, pp. 289–291.

[8] Concerning the usual length of confidentiality clauses, cf. J. Jehl, *Le commerce international de la technologie*, 1985, p. 167.

[9] Cf. G. Hertig, Transfer of Technology Agreements: the Pharmaceutical Industry Example, in International Chamber of Commerce, *Formation of Contracts and Precontractual Liability*, Paris, 1990, pp. 215–236.

First, they appear in contracts (or during the negotiation of contracts) concerning the research for or the transfer of technical information: research contracts,[10] know-how[11] and consultancy contracts,[12] technical assistance agreements, etc. This technical information is itself the value with which the contract is concerned, and it is necessary to protect it. If the information has been the subject of a patent, then it will have been published and its protection is achieved by an action against infringement; confidentiality clauses are then not relevant. But it is different when there is not, or not yet, a patent or when there is information surrounding a patent and necessary to put it to use. In such situations, the best protection is to keep the secrecy surrounding that information intact. If the secret needs to be shared with another party, it is necessary to oblige that party to keep to itself what has been revealed.

Various standard contracts or practical guides prepared by international organizations confirm the significance of confidentiality agreements in transfers of technology. Clauses on the subject appear in model contracts prepared by Orgalime on the subject of transfer of technology (Article 30).[13] Secrecy clauses are the subject of commentaries and advice in various guides prepared for international negotiators, in particular the "Guide for Drawing Contracts on International Transfer of Know-How in the Mechanical Industry" of the Economic and Social Council of the United Nations,[14] and the "Guide for Drawing Up an International Development Contract" prepared by Orgalime.[15]

Another substantial group of situations in which confidentiality undertakings flourish is that of the re-grouping of companies, acquisition of minority interests, takeovers, mergers, joint ventures, etc. To varying extent, these transactions lead to the revelation of a large quantity of financial, commercial and technical information to the other negotiating partner

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[10] Cf. Cl. Renard, Les contrats de recherches, in Commission Droit et Vie des Affaires de l'Université de Liège, *Aspects juridiques de la recherche scientifique*, 1965, pp. 39 and 55; P. Demaret, Analyse de quelques contrats de recherche, in *Aspects Juridiques . . .*, *id.*, pp. 67–68; M. Dubisson, *Les accords de coopération dans le commerce international*, 1989, pp. 194–195.

[11] Cf. J.M. Deleuze, *Le contrat international de licence de know-how*, 4th ed., 1988, especially pp. 34–41, 75–78, 89, 93.

[12] Cf. A. Hubert, *Le contrat d'ingénierie-conseil*, 2nd ed., 1984, especially pp. 135, 245–248.

[13] Orgalime, *Model International Contract for the transfer of technology*, EU/EEA version, June, 1997 and *International technology license agreement outside UE/EEA*, September, 1999.

[14] Doc. TRADE/222/Rev. 1; E.70.II.E.15, 1970.

[15] Orgalime, *Guide for Drawing Up an International Development Contract*, September, 1999, pp. 41–43; this guide provides model secrecy clauses.

that one cannot allow to be communicated to third parties. Thus the "Guide for Drawing up International Contracts Between Parties Associated for the Purpose of Executing a Specific Project" drawn up by the U.N. Economic Commission for Europe, contains several recommendations on the subject.[16] Frequently, when such a commitment is made during the negotiations, it also influences the very existence of the negotiations.

The practice of *data-rooms* leads to a sort of institutionalization of confidentiality undertakings in the corporate market. When a company is for sale, possible purchasers may be invited to find the necessary information by visiting a closed room where all the data useful for evaluation have been gathered. Access to the room is subject to the prior signing of a confidentiality undertaking.[17]

Confidentiality clauses are also common in contracts for the provision of computer equipment, concerning both the specific software to be developed and the information about the enterprise revealed for the development of such software.[18] Another important sector is that of contracts for the construction, the launching and the use of communication satellites.[19]

In a very different context, providing a publisher with certain information with a view to a possible publication can be accompanied by a confidentiality pledge. A French tribunal dealt with a case in which a periodical had published excerpts from a manuscript concerning Princess Diana in spite of the fact that the contract had not been concluded, and a secrecy clause had been agreed upon.[20]

Certain contracts intrinsically have less need for a duty of discretion. Contracts for the sale of goods, for the leasing of a building, for jobbing or for construction hardly present confidentiality aspects. But it can be different depending on the object of such contracts. A sale may relate to military arms or strategic material. A proposed construction may incorporate advanced technology. In such cases confidentiality clauses appear in the agreement between the parties. Thus, the new FIDIC contracts put restric-

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[16] Doc. ECE/TRADE/131, No. 69, 1979.

[17] On the practice of *data rooms*, cf. Ph. Marchandise, La libre négociation—Droits et obligations des négociateurs, in *Le droit des affaires en évolution*, Brussels and Antwerp, 1998, pp. 6–7.

[18] Cf. Y. Poullet, Le marché de l'information. Aspects contractuels: les clauses de confidentialité, *Rev. Dr. Aff. Int.*, 1989, pp. 939–975.

[19] Cf. L. Ravillon, *Les télécommunications par satellite—Aspects juridiques*, Paris, Litec, 1997, pp. 475–480.

[20] Paris, February 14, 1997, *Jur. Class. Pér.*, éd. gén., January 7, 1998, 25, note B. FAGES.

tions on the communication to third parties concerning documents prepared by the contractor.[21] The "Legal Guide on Drawing up International Contracts for Construction of Industrial Works" prepared by UNCITRAL also contains a section covering the confidentiality of the know-how provided (No. 23–25).[22]

Similarly a distribution contract may contain secrecy undertakings if it involves the transfer of sensitive information about the clientele, the market or the marketing processes, etc. A confidentiality clause appears in the model Exclusive International Agency Contract prepared by Orgalime (Article 8).[23]

In other sectors, the law or professional codes of conduct impose, in principle, secrecy obligations. This situation explains the absence or at least the rarity of confidentiality clauses in certain contracts. One does not require such an undertaking from the bank, from which one is seeking a line of credit, any more than one does from a doctor or a solicitor. Situations do arise, however, where an express confidentiality clause is used to duplicate and no doubt reinforce a pre-existing legal obligation. Thus, despite the rules, which, in many countries, oblige employees and ex-employees to respect the business secrets of an enterprise, it is not rare that employment contracts include a confidentiality clause and even that specific obligations are subsequently imposed on certain members of staff.

Confidentiality obligations are also found in the context of contracts that are subsidiary to a principal operation that is itself the subject of secrecy. Thus, suppliers, sub-contractors, intermediaries and advisers find themselves subjected to a secrecy obligation concerning data to which they have access during their participation in an operation.

The most original document found by the Group was a form issued by a public works authority, inviting tenderers to list, in great detail, confidentially, the various bribes they paid throughout the whole procedure.

3. Stages in the Life of the Contract

Confidentiality obligations appear at various stages in the life of a contract. Frequently such undertakings are created at the start of negotia-

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[21] FIDIC, *Conditions of Contract for Construction*, 1st ed., 1999, Art. 1.10 al. 3; *Conditions of Contract for Plant and Design-Build*, 1st ed., 1999, Art. 1.10 al. 3; *Conditions of Contract for EPC Turnkey Projects*, 1st ed., 1999, Art. 1.10 al. 3.

[22] Doc. A/C.N. 9/SER. B/2; E. 87.V.10, 1988.

[23] Orgalime, *Agency Contract—International Agency on an Exclusive Basis*, February 1990, reprint with amendments, June 1999.

tions,[24] during which it may be necessary to reveal data. It is important to protect those, especially if the negotiations should fail.[25] The situation is delicate, even more so if the negotiation involves the transfer of technology. One must reveal enough to motivate the other party to reach agreement, but if too much is said there is a risk that the latter may benefit from the information without being obliged to reach an agreement! One must therefore protect oneself by requiring the other party to enter in advance into an undertaking for confidentiality and non-usage. A first group of agreements and clauses therefore appears at this point.

If a contract is entered into, it will contain a confidentiality clause, and specific agreements on the same subject may be added, in particular with employees or other persons who will be associated with the performance of the contract.

Many confidentiality obligations also cover a definite or indefinite period subsequent to the expiry of the contract. In such cases, they provide protection against the revelation of the secret data after the end of the contractual relationship. We will return to this in more detail when analyzing the clauses.[26]

4. *Unilateral, Reciprocal or Parallel Obligations*

An obligation of confidentiality is often solely imposed on one party, namely the one that receives the information, but it is not unusual for the contract to provide reciprocal obligations where there is a mutual exchange of data.[27] Sometimes the obligations are parallel, in the sense that each party promises to keep the same information secret. Thus, an inventor may deliver his discovery to a company that is to use it; they will both pledge not to divulge it to third parties. A parent company may instruct a merchant bank to find a purchaser for one of its subsidiaries. It would provide the bank with a certain quantity of confidential information about this subsidiary with an obligation to confidentiality. In a parallel way, in order to assure itself of the exclusivity of its instructions, the bank would obtain from the parent company a promise that it will not reveal the information in question to anyone else.

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[24] Cf. the studies cited *supra*, of G. Hertig and of J. Huet & F. Toubol, as well as O. Capatina, *op. cit.*, No. 5.

[25] The firm which will provide information must also protect itself against overly generous disclosures by its representatives, *a fortiori* against "leaks" encouraged by corruption (cf. G. Hertig, *op. cit.*, pp. 224–225).

[26] Cf. *infra*, p. 280.

[27] Cf. on this O. Capatina, *op. cit.*, No. 3.

B. Systematic Analysis of Confidentiality Clauses

A well-drafted confidentiality clause deals with a series of questions. In the first place, it must define its subject matter, i.e., the data that are to be protected. Exceptions are necessary, however, e.g., for the situation where the knowledge envisaged is part of or may enter public domain. The secret information must often be shared in order to be of benefit; it is necessary to specify with whom (members of staff, certain co-contracting parties and so on) and under what conditions. An obligation may be characterized by its intensity; the clause may seek to express the degree of diligence required on the part of the person holding the confidential information. The secrecy undertaking will often specify the period of its duration, sometimes surviving the contract itself. Finally, difficult as it may be, it is advisable to specify in the clause appropriate sanctions in case of breach.

Such various aspects will be considered systematically by analyzing the 200 or so clauses that have been compiled taking into account the discussions that took place in the Working Group.

1. The Subject Matter of the Confidentiality

A confidentiality clause must start by defining its subject matter, that is to say the information that is to be kept secret.[28]

(a) Some examples are not very elaborate;

- "You should hold secret all know-how and other confidential information disclosed to you by the Company or its employees."
- "The term 'confidential information' shall mean all information disclosed under this agreement except . . ."
- ". . . tous les secrets d'affaires et de fabrication des autres members . . ."
- "Le contractant est tenu d'observer la plus grande discrétion en ce qui concerne les informations qui viendraient à sa connaissance dans les contacts avec l'institution ou dans l'accomplissement des tâches découlant du présent contrat et qui ne seraient pas encore rendues publiques."
- "All information which is of a confidential nature which either derives from either party to the Agreement under the provisions hereof or arises in connection with the performance of this Agreement or the conduct of the business of the joint venture . . .

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[28] On this matter, also see G. Hertig, *op. cit.*, p. 219; J. Huet & F. Toubol, *op. cit.*, No. 23–28; O. Capatina, *op. cit.*, No. 6.

or acquired by employees of either from observation of machines, processes and activities in the facilities of the other . . ."

As for the origin of the information, the first two examples cite information "revealed" by the other party. This may be too narrow; certain information is transmitted without any positive act from its original holder by the very fact of the relations created between the parties. In this respect, the three other clauses are preferable.

In another approach, the second example defines the confidential information by reference to specified exceptions (to which we will return later); similarly, the fourth example excludes information which has become public.

(b) It is often preferable to be more specific and to state which types of information are concerned.

1. The clause may provide that it is concerned with technical data communicated in the context of the contract, either in general terms or by reference to certain provisions in the agreement:

- ". . . all unpublished and novel technical information given to the Licensee under the provisions of this agreement not previously known to Licensee."
- ". . . any information concerning the other party's plant including techniques, processes, products, equipment or operations which may come within the knowledge of a party in the performance of or in connection with this Agreement."
- "'Information' as used herein shall mean design information, process flow diagrams, capital and operating cost data, and other information and data that may be owned by B . . . relating to the planning, design, construction, cost, preparation for start up, operation or maintenance of any of the processes and facilities of the plant."
- ". . . any and all (i) Information, know-how and data, technical or non technical, in any way relating to the subject matter of this agreement or to any process used or product or apparatus manufactured, used or sold by Buyer, which is disclosed to Seller by or on behalf of Buyer before, during or after the term of this agreement; (ii) Engineering data as defined in and covered by Article 11; and (iii) Subject Developments as defined in and cover Article 11."

The following clause inserts a list by way of an attempted definition:

"Par secrets d'affaires et de fabrication, il y a lieu d'entendre toutes affaires (procédés, techniques, thèmes et contrats d'études en

cours, contrats de recherche) qui sont à tenir au secret de par leur nature et dont la transmission à des tierces personnes . . . serait préjudiciable à X ou aux sociétés liées par contrat à X."

The formula is not a very happy one. The first criterion is tautologous and the second opens the door to much debate. It is preferable to provide a more objective specification of the confidential technical information.

An undertaking given during the negotiation of a contract for the transfer of technology may provide for initial confidential information for the purpose of evaluation and then stipulate that in any event the results of this evaluation are to remain confidential:

". . . All Results will be considered as Confidential Information."

2. Depending on the nature of the contract, data other than technical data can also be the subject of a confidentiality clause, e.g., information of a commercial or financial nature:

- ". . . any information relating to the business of the other . . ."
- . . . precios, estimativos, ofertas o cotizaciones respectos a la totalidad o parte de los trabajos materia del presente acuerdo . . ."
- ". . . alle den Verhandlungspartner und das Verhandlungssystem betreffenden Daten und Informationen . . ."
- ". . . information . . . about Companies' manufacturing processes and services, including information related to research and development, purchasing, accounting, engineering, manufacturing, marketing, merchandising and selling."
- ". . . any and all information . . . which relates to . . . , and may include, for example without limitations, data, know how, formulae, processes, designs, sketches, photographs, plans, drawings, specifications, samples, reports, price lists, vendor lists, studies, findings, inventions or ideas."
- ". . . all data, reports, interpretations, forecasts and records containing or otherwise reflecting information concerning any part of . . . the Business which you . . . may provide to us in the course of our evaluation of the possible acquisition described above . . ."

The following clause extends the application of confidentiality to data relating to third party enterprises:

". . . any information relating to the business affairs or finances of the other or of any member of the other's group or of any suppliers, agents, distributors, licensees or customers of the other where knowledge of the sale was received during the period of this Agreement."

Here, too, certain of the clauses only place the information under the seal of secrecy if they are "secret," which risks giving rise to problems of interpretation. One notes certainly that the confidentiality may attach to types of data as enumerated, but one still needs to determine among those data which of them are secret and which are not:

- ". . . any secret or confidential business or marketing plans or strategies of . . ."
- ". . . all technical and commercial information including but not limited to computer software, drawings, design, improvements, developments, additions, operational analyses, financial and marketing information and know how communicated by the parties to each other during the subsistence hereof, and which constitutes a trade secret or other confidential or proprietary information . . ."
- ". . . information, not generally known, about the Company's business, processes, products and customers, including, but not limited to, information relating to methods of manufacturing and processing Company products, inventions, purchasing, accounting, pricing, customers and lists, marketing, merchandising and selling . . ."
- ". . . any secret or confidential information whatsoever regarding the operation finances, business, products, processes, techniques, know how, suppliers, customers, dealings, transactions or other affairs of the Company or any of the subsidiaries or any of its or their suppliers or customers . . ."

Here is a clause that appears to consider confidential by nature information of a financial or commercial character, in contrast to information of any other type. It is taken from a contract relating to the commercial exploitation of a retail shop:

> ". . . any trade secrets; confidential knowledge or information or any financial or trading information of or relating to the store of . . ."

3. Confidentiality may be extended to the documents created by the recipient of the information himself when they reflect that information:

". . . analyses, compilations, studies or other documents or records prepared by you . . . to the extent that such analyses, compilations, studies, documents or records contain or otherwise reflect or are generated from such information . . ."

4. Sometimes it is the very existence of the contract, or its content, which must be kept confidential.

- "I will not disclose to any third party in any manner whatsoever the fact or nature of my association with A . . ."

- "The provisions of the present Agrement may not be disclosed to third parties."
- "The Vendors shall not . . . make any announcement regarding the existence or subject matter of this Agreement without the prior written consent of the Purchaser."
- "The Parties shall agree upon arrangements for prior reviews and consultations with respect to publicity releases or advertising regarding the Contract, this Consortium Agreement or the Work being performed."[29]

It may be negotiations themselves that are to be covered by secrecy:

- "Both parties shall use all reasonable efforts to maintain in confidence the fact that Recipient and . . . have entered into discussions . . ."
- "'Information' means . . . (ii) the fact that discussions and negotiations are taking place concerning any possible transaction with us . . ."
- "You will not . . . disclose to any person either the fact that discussions or negotiations are taking place concerning a possible transaction between the Company and you or any of the terms, conditions or other facts with respect to any such possible transaction, including the status thereof."
- "You will not make any public announcement with respect to any . . . proposed transaction between the Company . . . and you."
- "Such undertaking also applies to the fact that discussions are taking place in respect of the PURPOSE. In particular, any press release relating to such discussions or to any subsequent arrangement has to be agreed in advance by both parties."
- "Nous nous engageons . . . à ne pas divulguer le fait que les Informations aient été mises à notre disposition, que des négociations relatives à l'Opération soient en cours avec . . . ou que ces négociations aient été suspendues ou interrompues."

We will return later to the possible illegality that may attach to a confidentiality agreement covering the very existence of a contract.[30]

5. The following clauses define as confidential the very fact that one of the parties uses or does not use confidential data, information which might prove to be valuable to competitors.

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[29] Cf. also the clause in the famous "Memorandum of Agreement" executed on January 2, 1984 between Gordon P. Getty, the Getty Museum and the Pennzoil Company, according to which "The Trustees and Pennzoil (and the Company upon approval of the Plan) will coordinate any press releases and public announcements concerning the Plan and any transactions contemplated hereby." On this case, cf. *supra*, pp. 41–42, as well U. Draetta, The Pennzoil Case and the Binding Effect of Letters of Intent in the International Trade Practice, *Rev. Dr. Aff. Int.*, 1988, pp. 152–172.

[30] Cf. *infra*, pp. 291–293.

- "Seller shall in no event disclose that any Confidential Information is or is not being utilised by Buyer."
- "The very fact that we use such information for the manufacture of . . . shall be regarded by you as a trade secret and as a confidential disclosure."[31]

6. Sometimes it is the source of information that must be kept confidential even after the data themselves have lost their need of secrecy:

> "The Recipient shall not disclose . . . the fact that such Proprietary Information was furnished to the Recipient by the company or originated with the company and any correlation or identity which may exist between the Proprietary Information and any other information now or hereafter made available to the Recipient."

7. In certain cases the contract limits the character of confidentiality to information expressly described as such:[32]

> "Each party shall . . . maintain confidential . . . information disclosed to it by the other party in data sheets and reports pursuant to Articles 2 and 5 hereof and in any other writings designated as confidential by the disclosing party . . ."

Very frequently, such clauses distinguish between information disclosed in writing and that which, initially, was only oral:

> "Confidential Information' means all information, data and material . . . which when disclosed are marked 'Confidential' or 'Proprietary,' or, when disclosed orally, are clearly identified as 'Confidential' or 'Proprietary.'"

In this last case, the confidentiality must often be confirmed in writing within a certain time:

- ". . . all related communications and observations written or (if oral) reduced to writing and so identified within a reasonable time after oral disclosure . . ."

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[31] Y. Poullet, *op. cit.*, p. 964, points out the interest third parties could have in knowing the questions a firm puts to a data bank, which can reveal ongoing research, as well as present or future commercial initiatives.

[32] On such practice, also see G. Hertig, *op. cit.*, p. 222; J. Huet & F. Toubol, *op. cit.*, No. 24 et 26. In the case of a visit to a *data room*, definition of the scope of confidential information can be facilitated by a simple reference to all the data gathered in the closed room.

- “Each party will keep confidential any and all information communicated by the other party under this agreement provided said information is in written or tangible form and designated clearly as confidential, or if both the information and its confidential nature are confirmed in writing within 45 days in case of oral disclosure.”
- “The Parties agree that Information may be disclosed either orally or in writing. When disclosed in writing, the Information will be identified and labelled as Confidential. When disclosed orally, such information will first be identified as confidential at the time of oral disclosure, with subsequent confirmation in writing within thirty (30) days after such disclosure referencing the date and specifically identifying the Information orally disclosed. Each party agrees to clearly label as ‘Confidential’ all information reduced to writing by either party as a result of such oral disclosures. Each party agrees upon written request to provide a signed, dated receipt which itemizes the information transmitted to the other under the terms of this Agreement.”

This method risks provoking litigation in the event of indiscretion committed between the disclosure and the notification.

The possible variations are numerous and some of them invite comment. Thus, the following clause appears to authorize such indiscretions:

> “Information disclosed orally will be considered as non-confidential unless within thirty days after such oral disclosure, a written disclosure is submitted to you containing the information which was orally disclosed.”

Another clause, to the contrary, reduces the effect of the written confirmation:

> “Y data should be clearly identified as proprietary or confidential or if verbally transmitted as confidential provided always that such confidentiality is restated in writing by Y within two weeks after verbal communication by Y to X, but failure to make such identification or restatement will not affect the confidentiality of the Y data.”

Here it is the failure to mark a document “confidential” that may, in certain circumstances, be made good within a reasonable time:

> “Either Party, by affixing an appropriate legend, may identify any other documented information furnished by it to the other Party as the confidential or proprietary information of the furnishing Party or of its sub-contractors. In the event that any such informa-

tion is not marked as required herein and such failure to mark is discovered within a reasonable time and before use by the receiving Party which would be inconsistent with the provisions of this Agreement, the furnishing Party may notify the receiving Party of the material to be so marked and it shall be subject to the provisions of this Agreement."

The subsequent notification of the confidential character of information provided orally can give rise to abusive extensions of the obligation of confidentiality, since such a notification is given unilaterally. This was the case in several of the examples above, and the danger appears particularly in the following clause:

"To facilitate administration of this Agreement, it is agreed that following any oral discussion between you and ourselves of such Confidential information, we will prepare a written summary of such oral discussions and provide you with a copy thereof. Such written summaries, together with manuals, flow-sheets, drawings, specifications, designs and similar written data furnished to you by us shall be accepted by the parties as the total record of the Confidential information disclosed by us in confidence . . ."

This clause is difficult to understand, for the secrecy clause from which it is taken[33] provides earlier that the information is given in confidence:

"all technical information disclosed . . . to you."

The cumulative use of these two different approaches to the identification of the extent of the secrecy leads to a certain contradiction. The clause quoted first, in spite of its arbitrary character, is ultimately more restrictive that the wording that preceded it.

Another system envisages written notice in advance (or at the latest simultaneously) as to the confidential character of that which is about to be revealed orally:

- "X shall, prior to revealing any one or more items of proprietary information to any representative of Y, give written notice to such representative identifying either specifically or by class or group such one or more items as proprietary information . . ."
- "All and any information that is to be treated as confidential shall be so labelled in writing, in the case of reports and other documents, on the face thereof, and in the case of oral disclosures, in

[33] The full agreement can be found in J.M. Deleuze, *op. cit.*, pp. 135–136.

the form of a specific notification to the recipient made prior to or contemporaneous to the disclosure."

This method permits one to make *ab initio* the reservations necessary if one wishes to avoid falling into what may be the trap of confidentiality, even to refuse to take note of certain information in order to keep one's freedom of action.[34]

The express and specific indication of the confidential character of certain material is intended to create greater clarity as to the field of application of the secrecy obligation. This advantage appears weakened in the event of use of a clause such as the following:

> "Each of the Parties agrees to keep confidential all information marked confidential and which, by its very nature, can reasonably be taken to be confidential received from another Party."

If such a clause is used, the annotation "confidential" does not suffice in itself; it is still necessary that the information satisfy the conditions expressed in the second part of the clause. Such drafting is to be avoided.[35]

8. The definition of the subject matter of the confidentiality by means of lists of types of data or by marking the documents implies, on the other hand, that other information is not within the secrecy obligation. One must be very careful when adopting such delimitations.[36]

There is a risk of abusing the "confidential" marking by placing it on too many documents, to the point of turning into a boilerplate provision, the effectiveness of which is very much weakened.

2. *Exceptions Made as to Types of Information*

Having decided what information is, in principle, the subject of the obligation of confidentiality, the clauses seek to limit the protection provided by creating various exceptions as to the knowledge targeted. Certain

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[34] It happens that a negotiator initially declares that any information that will be given to him or his representatives will be considered as non-confidential, and that it does not wish to receive confidential information (F. Störi, *Forschungs- und Entwicklungsverträge,* Thesis, Zürich, 1979, p. 163, cited by G. Hertig, *op. cit.,* p. 224 and note 25). This method is probably reserved to firms with a strong bargaining power, unless the negotiation normally concerns only information in the public domain.

[35] In another interpretation, this clause presumes to be confidential, all information labeled as such, subject to proof to the contrary according to the criteria stated in the second part of the clause. If such was the intention of the drafters, the language used is hardly satisfactory.

[36] Cf. J. Huet & F. Toubol, *op. cit.,* No. 26–28.

types of information, which come within the given definition (e.g., technical, commercial, financial, etc., data), are not to be subject to the secrecy obligation.[37]

There are three classic categories of such exceptions.

(a) Firstly, no confidentiality obligation applies to information received that is already in the public domain.

> "Seller's obligations under paragraph (a) above shall not apply to confidential information that is . . . known to the public."

The exception is frequently extended to information which subsequently falls into the public domain:

- ". . . unless and to the extent such information is or later becomes generally available to the public."
- ". . . information which was at the time of disclosure in the public domain or after such disclosure . . . becomes a part of the public domain . . ."
- ". . . (a) technology which at the time of disclosure . . . is in the public domain . . . (b) technology which after disclosure . . . becomes part of the public domain . . ."

The presence of information in the public domain can be demonstrated from a publication or from other circumstances, and certain clauses deal with this aspect:

- ". . . so long as it remains unpublished or not generally available to the public."
- ". . . which is or becomes generally known to the public through publication or falls into the public domain or is available from observing a public demonstration or use thereof."
- ". . . information . . . which is disclosed in any patent application laid open or otherwise exposed to the public . . ."
- ". . . unless such disclosure occurs by its use in the Products manufactured by either party or by the sale of such Products."

It may be useful to try to specify what is meant by "enters the public domain."[38] First of all, the concept requires sufficiently extensive public

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[37] On this aspect, also see J. Huet & F. Toubol, *op. cit.*, No. 27–28; J. Jehl, *op. cit.*, p. 168; O. Capatina, *op. cit.*, No. 6.

[38] Comparison may be made with the notions of "*disclosure*" and "*availability to the public*" used in patent law about the requirement of novelty and the establishment of a possible priority (cf. J.M. Mousseron, *Traité des brevets*, 1988, pp. 248–285).

knowledge. It is not sufficient that scientific information is in the possession of a few specialists; it should be "common knowledge" in the field, as expressed in the following clauses:

- ". . . any information which is or becomes generally available to the public in printed publications of general circulation."
- "It is understood and agreed that any information known only to a few people to whom it might be of commercial interest and not generally available to the public cannot be deemed to be in the public domain."

One may require that the exception be limited to knowledge generally available in the country concerned. Confidentiality would remain applicable to information that might be available elsewhere in the world:

> . . . information which prior to our receipt thereof . . . is published in the United Kingdom or is otherwise in the public domain in the United Kingdom."

The examples that follow also seek to restrict the extent of the public domain exception in order to avoid certain problems of interpretation.

- "Y agrees that any information which is specific to process conditions or features or to any combination of process steps utilised in the Plant shall not be deemed to be a part of the public knowledge . . . by virtue of the fact that it may be contained within broad disclosures which are part of the public knowledge . . ."
- "Les 'informations' communiquées par l'une des parties ne seront pas considérées comme disponibles ou publiées . . . par le simple fait qu'elles peuvent être tirées d'une combinaison de publications généralement disponibles ou publiées . . ."
- "It is understood and agreed that a combination of two or more portions of the Proprietary Information is not to be deemed to be within the public domain merely because each portion separately is available to the public."

Not all cases where the information has entered the public domain lift the obligation of confidentiality. It is still necessary that this public knowledge did not result from some wrongdoing on the promissor's part. This requirement is very frequently expressed, even though it may appear superfluous:

- ". . . except to the extent such data and information are in or hereafter come within the public domain without fault on the part of the Seller."

- "... technology which becomes part of the public domain, except by breach of this agreement ..."
- "... information which ... becomes generally available to the public other than as a result of disclosure by you or your directors, officers, employees, agents or advisors ..."
- "... it becomes published or otherwise available to the public through sources other than Smith, any subsidiary or affiliate of Smith, or any distributor of such subsidiary or affiliate."

(b) Also frequently excluded from the obligation of confidentiality is information that was already in the possession of the contracting party. This exception is not to be confused with the preceding one. The contracting party might already hold information that is otherwise exclusive or little known.

- "Any information communicated in confidence under this Agreement by either party shall be treated by the other party as confidential, unless ... such information was in the Licensee's possession at the date of its receipt from the Licensor."
- "Si toutefois les données ... sont déjà en possession de l'Université ... l'Université ne sera pas tenue de les considérer comme étant de caractère confidentiel."
- "The foregoing limitations ... shall not apply ... if the Receiving Party has rights to the information under any other agreement relating thereto ..."

The exception may be extended to knowledge already in the possession of other companies in the group:

> "Les obligations ... ne s'étendent pas aux informations qui étaient déjà en la possession de la partie réceptrice et de ses sociétés apparentées ..."

Some clauses extend the exception to knowledge discovered by use of its own resources by the beneficiary subsequent to the transfer of the information:

- "aux informations qui sont développées indépendamment par la partie réceptrice ou par ses sociétés apparentées ..."
- "... if such information was known to either party prior to such disclosure or is independently developed by either party subsequent to such disclosure ..."

One will notice the difficulties to which such clauses can give rise. Can one imagine that a party in receipt of confidential information "rediscovers" them "independently"?

The next variation is interesting; it assimilates the exception for prior knowledge to that of the public domain:

> "The foregoing limitations shall not apply if the information is or becomes available to the receiving Party by inspection or analysis of products available in the market."

It may be useful to specify that the benefit of the exception assumes that the prior knowledge does not originate from the co-contracting party nor from a related company, nor that it is itself the result of a breach of secrecy.

- ". . . data which . . . were not acquired directly or indirectly from W or any of its affiliates or licensees and which you can show were in your possession prior to the time of the disclosure to you."
- ". . . information which the receiving Member can show was in its possession prior to disclosure and which was not acquired directly or indirectly from any other Member."
- ". . . except insofar such information . . . was in the possession of a party prior to the disclosure to it by the other party and such information was not covered by a secrecy obligation . . ."
- ". . . information which . . . is already in your possession, provided that such information is not known to you to be subject to another confidentiality agreement with or other obligation of secrecy to the Company or another party . . ."

A party invoking the exception for prior knowledge is sometimes bound to give prompt notice to his contracting partner.

> "The obligations of Article 28 hereof shall not apply to any information when, if and to the extent . . . the party receiving such information promptly advises the disclosing party that it possessed such information prior to the disclosure thereof."

Such response may, in particular, arise after the notification that particular information is to be treated as confidential, in accordance with the procedures described above.

What is crucial to the application of this exception is that there be proof of prior knowledge. It is clearly not sufficient merely to affirm that the information received was already known so as to be relieved from the obligation of confidentiality. The affirmation must be justified.

- "Cet engagement ne s'applique toutefois pas aux informations dont vous pourriez montrer . . . qu'elles étaient . . . en votre possession préalablement à leur communication par notre Société."

- "... when it can be shown that the information was kept in written form in the files of the Receiving Party before it was transmitted by the other Party."
- "... said term shall not include information what was either in the possession of the Licensee at the date of receipt from Licensor as evidenced by the Licensee's written records, or can be shown by the Licensee to have been independently developed ..."

A technique that is sometimes employed, on entering into negotiations where information may be transmitted confidentially, is to deposit with a notary public or other independent third party a precise inventory of the knowledge one already has.[39]

(c) Also frequently excluded from the secrecy obligation is information obtained from a third party not being itself under an obligation of confidentiality as regards the promissee, or at least not having obtained it from the promissee.

- "I understand that the foregoing restrictions do not apply to information ... which I acquire from others not under an obligation of secrecy to A."
- ". . . the information which Receiving Party can show that was received by it after disclosure hereunder from a third party which to the best of the knowledge of the Receiving Party was not directly or indirectly derived from the Supplying Party."

Some clauses refuse to make an exception for information received from a third party in breach of secrecy obligations with regard to other persons, or, more generally, unlawfully.

- "... information which ... becomes available to you on a non-confidential basis from a source other than the Company or its advisors, provided that such source is not known to you to be bound by a confidentiality agreement with or other obligations of secrecy to the Company or another party ..."
- "... information which ... was within your possession prior to its being furnished to you by the Company, provided that the source of such information was not known to you to be bound by a confidentiality agreement with the Company or to be otherwise prohibited from transmitting the information to you by a contractual, legal or fiduciary obligation."
- "Le présent engagement ne s'appliquera pas aux informations dont vous pourriez établir ... qu'elles vous ont été communiquées

[39] This technique is also mentioned by G. Hertig, *op. cit.*, p. 222; cf. the precautions suggested by J.M. Deleuze, *op. cit.*, pp. 39–40.

ultérieurement par un tiers pouvant le faire licitement et sans restriction quant à l'usage ou au caractère confidentiel des dites informations."

Furthermore the exception is commonly limited to the case where the disclosure is made by a third party to the promissor on a non-confidential basis.

". . . except insofar such information . . . is received from third parties without restrictions on use or disclosure to others, provided that the third party does not have an obligation of secrecy or is not in breach of such secrecy obligation."

This feature is indeed present on its own in the following clause, which fails to insist that the third party not be itself under obligation of confidentiality.

"The obligations of this Part V shall not apply to any information . . . subsequently obtained from a third party on a non-confidential basis."

Some other provisions are, on the other hand, most meticulous.

". . . information acquired on an unrestricted basis from any third party provided that the acquiring party does not know or have reason to know or is not informed subsequent to disclosure by such third party and prior to further unrestricted disclosure by Purchaser that such information was acquired under an obligation of confidentiality."

Some of the examples just given make an exception for information received from third parties whatever the time of that disclosure, while others limit the exception to revelations made prior to the disclosure of the other contracting party. This comes close to the exception made for prior knowledge.

In several examples, there is an express requirement for proof, a requirement already met as to the exception for prior knowledge. The following clause establishes a system of notification and of proof common to the three exceptions that have been examined:

". . . provided that within sixty (60) days from the time such Confidential Information is disclosed to Seller . . . Seller furnishes to Buyer reasonably convincing evidence that such Confidential Information satisfies the requirements of (i), (ii) or (iii) above."

(d) Another exception, which is self-evident, is sometimes envisaged explicitly: the promissor is relieved from his obligation of confidentiality if he obtains the consent of the promissee for a disclosure that would not otherwise be authorized by the contract.

- "You shall not, without the prior written consent of the Company, disclose such confidential information to any person . . ."
- "In addition to the disclosures permitted under paragraph (a) of this Article, any information received from the other party may be disclosed with the consent of such other party as to content and recipients of the disclosure."

(e) One might also envisage the possibility that one of the parties would take steps to cancel the confidential status of one or another information furnished by it:

> "Les obligations . . . ne s'appliquent pas . . . aux informations pour lesquelles la partie qui les aura révélées aura indiqué par écrit à l'autre partie qu'elle leur retirait la caractère confidentiel."

(f) Other exceptions turn on the limited nature of certain authorized disclosures:

- "Je maintiendrai secrètes ces informations reçues sur base de la confiance qui m'est accordée pendant une période de . . . ans et je m'abstiendrai de les publier ou de les divulguer à des tiers, y compris ma propre société, dans la mesure où elles dépasseraient le domaine des généralités."
- "Now, therefore Inventors and . . . agree as follows: for 2 years after the effective date of this Agreement . . . shall limit disclosure of such information to opinions as to when and/or whether the arrangement or portions thereof can be commercially exploited."

(g) The foregoing exceptions and especially the first three (the public domain, prior knowledge, disclosure by a third party) are extremely common. However, certain confidentiality clauses do not provide for them or do not include them all. One clause may limit itself to a mere general expression imposing confidentiality on all information provided. Another clause may provide the exception for the public domain but no others, and, in particular, not that for prior knowledge.

The attention of draftsmen is drawn to the inconveniences of such omissions, inasmuch as these exceptions, if duly specified, appear eminently reasonable and they are in general use. The process of interpretation and an appeal to common practice may no doubt overcome many

drafting deficiencies, but clear and complete drafting is by its nature useful to avoid disputes.

3. Exceptions Made as to Persons (Sharing the Secret)

The obligation not to reveal information received is often also made subject to a different kind of exception. Permission may be given for the secret to be communicated to certain people. Firstly, this relates to members of the staff of the enterprise but also, according to the circumstances, to its subsidiaries, its clients, suppliers, sub-contractors, distributors, advisers and even to public authorities. In many cases, the authorization to share the confidence is accompanied by an obligation to seek an obligation of confidentiality from these persons. These two aspects will be considered in turn.

(a) Categories of persons

1. Firstly, it is to certain members of staff that the information may often be transmitted, insofar as it is necessary so that the data might be exploited.[40] This last qualification is often expressed by a reference to the aims of the parties.

- "Seller shall not disclose . . . except to such of its employees . . . who need such Confidential Information in order to properly perform the work."
- "Seller shall limit disclosure of the data to those of its employees having a need to know such data in order to carry out the Services."
- "The Proprietary Information shall be only disclosed to . . . those persons within the . . . organization who have a need to know and solely for the purpose specified in this Agreement."
- "Nous nous engageons à ce que seuls nos administrateurs, fondés de pouvoir, employés et autres représentants qui sont concernés par l'Opération aient accès aux Informations."

The beneficiaries of this exception are sometimes defined broadly as in the above example; in other clauses an attempt is made to list the categories of personnel envisaged if only by way of example.

- ". . . only to those chosen servants, agents and employees to whom disclosure is reasonably necessary for that purpose."
- "Any of such information may be disclosed to your directors, officers and employees . . . who need to know such information for the purpose of evaluating any such possible transaction between the Company and you . . ."

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[40] On this aspect, also see J. Huet & F. Toubol, *op. cit.*, No. 30.

- "... to you and your 'representatives' (which term includes collectively your directors, officers, employees, agents or other representatives, including without limitation attorneys, accountants and consultants) ..."

It will be noted that the last clause quoted includes persons who are not actually employed.

One clause among those studied provided for the prior delivery of a list of those employees entitled to be shown the information:

> "With respect to any exchange of Proprietary Information which may occur as a result of this agreement, it is expressly understood and agreed that the below listed employees shall ... be the exclusive individuals authorized to receive Proprietary Information under this Agreement ..."

2. Some contracts authorize transmission of the information to subsidiaries and related companies, within appropriate limits.

- "The parties may transmit any information disclosed to its Associated Companies for evaluation ..."
- "Die Parteien sind sich darüber einig, dass die Gesellschaft ... diesen Tochter- und Beteiligungsgesellschaften nur solche Auskünfte über den Vertragsgegenstand geben wird, die für die Ausführung der diesen übertragenen Aufträge erforderlich sind."

Such disclosures may prove necessary, but attention is drawn to the special risk of unauthorized disclosure thus created. There are cases of disclosure to alleged "subsidiaries" that are merely correspondents against whom no remedy will be available in the event of subsequent discovery. It is essential to know the identity of the third parties to whom information may be transmitted and to take appropriate precautions in particular with respect to the undertakings that should be subscribed by those third parties and to the promissee's responsibilities arising from their conduct.

In the absence of such provisions, the other companies in a group are not generally entitled to the transmission of data. Some agreements emphasize this:

> "... it being understood that third parties shall also mean companies and/or persons controlling the Receiving Party or controlled by it."

3. In the case of suppliers and clients, sub-licensees and sub-contractors, distributors and tenderers and other categories of persons, it is sometimes necessary to tolerate the revelation of confidential information.[41]

- "Le licencié pourra toutefois communiquer à des tiers fournisseurs ou sous traitants toutes les connaissances techniques nécessaires pour la réalisation et la mise en place du matériel."
- ". . . the party receiving such disclosure shall not disclose any of the know-how . . . to any person . . . other than . . . (b) responsible contractors, sub-contractors and machinery suppliers, only to the extent necessary for erection, expansion and maintenance of the plants."
- ". . . unless such information must necessarily be disclosed by either party to its customers, users or licensees of the Products, to bona fide authorised subcontractors and bidders to enable them to perform their contract or make bids to either party . . ."
- ". . . except that disclosure may be made to buyers and potential buyers of the Product only to the extent necessary for their use."

This clause includes several qualifications:

- ". . . Cet engagement ne fait . . . pas obstacle à la communication à vos clients des informations normalement accessibles aux acquéreurs de ce matériel; cependant, les plans de détails resteront confidentiels sauf accord particulier de la direction de X."

Here is a particularly broad version:

". . . any other persons to whom the handling on of said information may be necessary in order to fulfil the objective of this agreement . . ."

Very frequently, the contract requires the promissor to obtain confidentiality obligations from these recipients; we will return to this. That is, however, not always the case:

"Each party may disclose on a non-confidential basis to their sub-licensees and to purchasers and potential purchasers of the Experimental Compounds and Licensed Compositions, such of the aforesaid information as is reasonably necessary to facilitate the sale and use of the Experimental Compounds and Licensed Compositions and to facilitate the manufacture of the Licensed Compositions."

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[41] *Id.*, No. 31.

On the other hand, it sometimes happens that a confidentiality clause contains an express injunction against revelation of the information to certain categories of persons.

"En aucun cas, l'information sur le Procédé ne sera communiquée aux soustraitants, de B, qui, au titre de l'article 2, seront considérés comme des tiers."

4. Financial and insurance aspects may also cause necessary exemptions from confidentiality obligations:

- ". . . unless such disclosure to the extent required is . . . reasonably necessary for financing purposes."
- ". . . except . . . information required for credit or insurance of the Project, to the extent necessary for such purposes."

5. The giver of the confidentiality undertaking may have authority to share the information with his advisers:

- ". . . except to their respective professional advisers . . ."
- "Eu égard à toutes informations afférentes à l'organisation de son partenaire contractuel, ainsi qu'au déroulement des affaires dont il aura pris connaissance, X n'en fera pas de déclarations envers les tiers et tiendra le secret absolu. En est exclu le conseiller juridique et fiscal de X . . ."
- "Ce document contient des informations qui sont la propriété de . . . II sera traité confidentiellement. II est défendu de . . . transmettre ou de révéler à des tiers les informations contenues, dans ce document . . . si ce n'est en cas de nécessité pour permettre une évaluation bona fide de l'offre."
- "Par dérogation à l'interdiction formulée à l'article 2 du présent Engagement, nous nous réservons le droit de communiquer les Informations à nos conseillers consultés dans le cadre de l'Opération . . ."

6. It is sometimes necessary to reveal the confidential information to public authorities, for example, in cases of technology transfers, restrictions on competition, tax statements, labor regulations or financial operations.[42] Where applicable that fact should be mentioned.

- "Each party may disclose . . . to applicable government agencies, such of the aforesaid information as may be necessary to comply with applicable statutes and regulations relating in any way to the manufacture, use or sale of . . ."

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[42] *Id., loc. cit.*

- "It is understood and agreed that . . . may disclose on a confidential basis such information to . . . the Food and Drug Administration . . . as may be customary or necessary . . . to obtain New Drug Applications."
- ". . . except that you may make such disclosures (after making reasonable efforts to both avoid such disclosure and advise the Company of your intention to do so) which must be made under the securities law."
- ". . . except with regard to Algeria, the following agencies: Ministry of Heavy Industry, Ministry of Finance, Customs . . ."
- "Über seine Vergütung hat der Mitarbeiter dritten Personen gegenüber Stillschweigen zu bewahren. Dies gilt nicht für die Fälle, in denen er gesetzlich berechtigt oder verpflichtet ist, Angaben über sein Einkommen zu machen, wie beispielsweise dem Finanzamt, dem Arbeitsamt oder einer sonstigen staatlichen Stelle."
- "Each party may disclose the other's Confidential Information to the extent such disclosure is reasonably necessary in filing or prosecuting patent applications under the terms of the Patent Transfer Agreement or to comply with government regulations."

7. This last example enables us to turn to the problem of constraints on confidentiality arising from the requirements of judicial or administrative procedures. It is a delicate subject. We will return to it in more detail.[43] At this point, we limit ourselves to quoting several clauses from our sample.

An exception may be provided in fairly broad terms:

- "The licensee shall not disclose . . . unless . . . ordered to do so by a Court of competent jurisdiction."
- ". . . unless such disclosure, to the extent required is . . . (b) reasonably necessary for the purposes of any . . . legal proceedings involving both parties; . . . (f) reasonably required in proceedings taken by either party for the enforcement of any of its rights and remedies hereunder."

But some contracts address the issue with very elaborate clauses:

- "In the event that either party is requested or required by any court or government agency or authority or pursuant to any subpoena, request for information, interrogatories, civil investigative demand, or similar process to disclose any information received by it, it will promptly provide the other party with notice of such

[43] Cf. *infra*, pp. 293–295; also see J. Milquet, La production en justice, par un cocontractant, de renseignements et de documents protégés par une clause de confidentialité, *Rev. Dr. Aff. Int.*, 1991, pp. 153–167.

request so that such other party may seek an appropriate protection order and/or waive compliance with the provisions of this Agreement. It is further agreed that if, failing the entry of a protective order or the receipt of a waiver hereunder, the requested party is in the opinion of its counsel compelled to disclose such information under the pain of liability for contempt or other censure or penalty, such requested party may disclose such information pursuant to such request without liability hereunder."

- "In the event that you or anyone to whom we transmit the information pursuant to this Agreement are requested or become legally compelled (by oral questions, interrogatories, request for information or documents, subpoena, civil investigative demand or similar process) to disclose the information you will provide X with prompt notice so that X may seek a protective order or other appropriate remedy and waive compliance with the provisions of this Agreement. In the event that such protective order or other remedy is not obtained and to the extent that X has not waived that portion of the information which your counsel advises you are legally required to disclose, you will exercise your best efforts to obtain reliable assurance that confidential treatment will be accorded to such information."

These clauses contain various interesting elements: the obligation to warn the other contracting party so that it may take the steps necessary for protection or may release the secret, an obligation to try to obtain confidential treatment of the information on the part of the authorities[44] or an exemption from liability for such obligatory disclosures.

Here are two further examples:

- ". . . the receiving party is entitled to pass on INFORMATION or parts thereof to the competent authorities to the extent required by law. In such a case, the receiving party shall inform the disclosing party about the legal requirement to communicate INFORMATION and the parties shall discuss in good faith about the best manner to narrow the scope of the INFORMATION to be communicated to the authorities."

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[44] In many cases, authorities are themselves legally bound to a duty of confidentiality concerning certain information transmitted to them. Cf., for instance, Article 287 (former Article 214) of the EU Treaty. The Hoffmann-Laroche case and its tragic epilogue will be remembered (cf. Stanley Georges Adams c/ Commission of the European Communities, Eur. Court of Justice, Nov. 7, 1985, *E.C.R.*, 1985, 3595; cf. J. Biancarelli, Chronique internationale, Droit communautaire, *Rev. Sc. Crim. et Dr. Pén. Comp.*, 1986, pp. 449–452).

- "Si par suite d'une action en justice de l'application d'une loi ou d'un décret du gouvernement le bénéficiaire se voyait dans l'obligation de divulguer des informations confidentielles couvertes par le présent contrat, il lui incomberait alors d'en informer le fournisseur et si ce dernier le lui demande de coopérer avec lui pour s'opposer à cette divulgation. Aucune des deux parties ne sera passible de dommages-intérêts pour une divulgation survenant à la suite d'une action judiciaire ou de l'application d'une loi ou d'un décret du gouvernement sauf si le bénéficiaire manque à l'une quelconque de ses obligations stipulées par le présent article."[45]

These texts, and particularly the second one, are somewhat surprising inasmuch as they seek to create obligations to cooperate within the restrictive application, or even the defeat of mandatory rules. Certainly the principles governing disclosure to the courts or to other authorities sometimes authorize those concerned to seek dispensation, but, in many possible circumstances, at least the second foregoing clause would appear to be doubtful legality. Even the mere obligation to warn one's partner of the demand made by the authorities, also envisaged by the two preceding clauses, might give rise to problems of validity. We will return to this.

A more civic approach inspired the following clause:

> "Der Verkäufer und der Kaüfer vereinbaren, den Inhalt dieses Vertrages vertraulich und gegenüber Dritten geheim zu halten, es sei denn, sie sind dazu verpflichtet, diesen gegenüber einem Gericht, einer Behörde oder anderweitig offenzulegen bzw. mitzuteilen. Die Vertragparteien werden in solchen Fällen nach besten Kräften bemüht sein, die Vertraulichkeit soweit als nur möglich zu bewahren, ohne dabei aber den Gerichten oder Behörden die erforderliche Auskunft vorzuenthalten."

8. The following clause is interesting, authorizing, subject to certain conditions, disclosure for the purposes of scientific publication.

> "Recognising the desire of the scientists involved in . . . to publish certain work done during . . . in reputable scientific journals, the parties agree to confer and consult one with the other where any anticipated scientific publication by the employees of one party arising from . . . ought, for the sake of completeness, to contain the Technical Know How or Confidential Information of the other with a view toward resolving the competing interests of confidentiality and desired scientific credit through publication in a man-

[45] Clause taken from a confidentiality agreement cited by J. Huet & F. Toubol, *op. cit.*

ner fairly and reasonably consistent with the interests of the parties on the one hand and those of the scientists concerned on the other. No such publication shall be made, nor any manuscript submitted for publication, until each party has had ample opportunity to review the same and, if desired, to effect associated patent filings so as to preserve U.S. or foreign patent rights. Should the party to whom the manuscript is submitted reasonably believe that publication thereof would be detrimental to its interests such party shall inform the other of such fact and its reasons and the other party shall not publish the same for a period of 90 days thereafter and shall delete any Technical know-how or Confidential Information from the manuscript as directed by the other party to whom the manuscript is submitted for approval."

9. Finally, we would like to quote a clause whose general structure, in spite of its apparent strictness, would seem to permit without any restriction, communication to any person of the information provided the disclosure is justified by the purposes of the contract.

"Any know-how or other information, advice or assistance made available by either Member Firm to the other shall be retained in the strictest confidence and shall not without the express prior written consent of the initial supplier of the information be disclosed or divulged to anyone . . . in any respect or to any extent other than for the purpose hereof."

The purposes of the contract can certainly justify exceptions from the obligation of confidentiality, but as far as drafting is concerned, one is struck by the contrast between the strictness, which appears in the greater part of the clause, and the relative vagueness of the last six words.

Some contracts do not authorize initially the disclosure of data to certain third parties but envisage a specific consent.[46] Here are two examples relating, in one case, to affiliate companies and subcontractors and in the other to advisers.

- "Chaque partie devra obtenir l'accord de l'autre partie pour divulguer à ses Sociétés Apparentées ainsi qu'aux soustraitants . . . les informations confidentielles de l'autre partie . . ."
- "X may disclose Proprietary Information to individual consultants or employees of companies that become consultant companies who need it to carry out the promotional activities hereunder, pro-

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[46] Cf. *mutatis mutandis*, the similar exception described above concerning the types of information excluded from the secrecy obligation.

vided Y has authorized in writing to extend an agreement to each such consultant . . ."

This recalls the warning expressed above in connection with disclosure to companies in a group.

Sometimes the contract formally permits disclosure to certain third parties and establishes a system of permissions for disclosure to others:

- "In the event either of the parties should desire to communicate all or part of the provisions of this agreement to parties other than those set forth above, it must obtain prior written approval of the other party."
- "When disclosure of Y data to any third party is essential, X will prior to such disclosure obtain Y's consent to disclose such Y data . . ."
- "Each party may make such further disclosures as may be permitted by the other party in writing and such permission shall not be unreasonably withheld."

Visits to factories give rise to many indiscreet glances. The following clause arises in this context:

"Le vendeur pourra organiser des visites de l'ouvrage notamment pour le montrer à ses clients. A cet effet, le vendeur communiquera à l'avance au Maître de l'Ouvrage, les noms et qualifications des visiteurs . . . Toutes prises de vue et visites sur le chantier sont subordonnées à l'accord préalable écrit du Maître de l'Ouvrage."

Even when authorized by the contract, disclosure to third parties may give rise to the need for notification to the other contracting party. Some examples have already been given, in particular in connection with divulging information in court proceedings. Here is another example:

"A shall keep B informed in writing of any and all disclosures pursuant to paragraph (a)."

It is not rare to require lists of persons with privileged information.

- "You further agree . . . to furnish us a list of officers, employees and consultants to whom you have given access to such Confidential Information . . ."
- "Y shall once a year within 20 days of a written request from X supply X with an accurate, detailed and up-to-date record in writing of all employees and consultants of Y to whom such source has been disclosed."

The supply of the list is sometimes required in advance:

> "You agree to notify ABC, prior to the delivery or disclosure of any information to your third party representatives or affiliates, as to the identity of such representatives or affiliates."

We have already seen above similar clauses envisaging the prior supply of lists either of employees liable to receive the information or of visitors to the works.

(b) Extension of the Obligation of Confidentiality. Are persons with whom the secret may be shared themselves expected to keep the secret?

Initially, such persons are not in a contractual relationship with the supplier of the information and therefore the confidentiality clause does not bind them directly.

In certain cases, they may nevertheless be subjected to an obligation of confidentiality resulting from their employment contract, from the law or their professional status.[17] The supplier of the information will wish to reinforce its legal protection. Quite frequently it requires the contracting party to obtain a specific confidentiality undertaking from the persons to whom the secret is to be transmitted. This practice first gives rise to a new commitment on the part of the other contracting party (1) and then brings the third party within the bounds of a personal confidentiality pledge (2).

1. The initial recipient of the data finds himself subject to various obligations as concerns the transmission of information to third parties.

Some clauses consider it useful to provide expressly what seems an obvious requirement, *viz.* to indicate the confidential nature of the information to those to whom it is transmitted:

- "Each party will divulgate the received information to its employees . . . stressing to these employees the confidential features of such information."
- Such directors, officers, employees and representatives shall be informed by you of the confidential nature of the information and shall be directed by you to treat such information confidentially."

As is the case with the second clause just quoted, other versions put emphasis on the obligation for the contracting party to require compliance with the confidentiality from staff.

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[17] Cf. *infra*, pp. 289–290.

- “Chaque partie . . . s’engage à donner les instructions appropriées aux membres de son personnel appelé à avoir connaissance d’informations confidentielles de l’autre partie dans le cadre de l’exécution du présent contrat.”
- Each party shall procure that its respective servants and agents shall at all times during and after expiry or termination of this Agreement keep confidential all technical documents and information provided to it . . .”

The recipient contracting party undertakes personal responsibility in this respect. This is emphasized in numerous clauses.

- “You agree to assume responsibility for the actions of such of your executives and employees who may have access to technical information.”
- “You shall be responsible for any breach of these obligations by any of your officers, directors, employees or professional advisors.”
- “Each party guarantees the respect of the secrecy by its employees.”
- “Chaque partie se porte fort du respect du secret par son personnel.”
- “Le preneur de licence se porte fort pour ses agents, partenaires, compagnies affiliées, parties contractantes, personnel, actionnaires et subalternes, de prendre toute mesure pour que le produit soit conservé et protégé contre le vol, la duplication, la publication, la divulgation et la communication à des tiers.”
- “You will be responsible for any breach of such terms by your Representatives, and will indemnify and hold harmless PARENT, any other member of the PARENT-group and any successor in title to the Possible Transaction for any losses, damages, charges, fees or expenses arising out or resulting from such breach.”

One notes the variations between these clauses. The legal basis of the undertaking to be responsible for indiscretions of another will be discussed below.[48] We will also quote the following more detailed clause, which expressly excludes any responsibility on the part of the firm if the indiscretion is exclusively attributable to the one person responsible and the firm having taken all measures that could reasonably be required:

> “X responderá de cualquier infracción de esta obligacion de confidencialidad que fuese cometida por cualquiera de las personas mencionadas en el párrafo anterior, siempre y cuando el infractor se halle bajo el control efectivo de X y sea probado que X no adoptó las medidas razonablemente exigibles y adecuadas para el control de la información confidencial recibida.

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[48] Cf. *infra*, pp. 288–289.

> "Por el contrario, X no asume responsabilidad de ninguna clase cuando la violación de las obligaciones de confidencialidad sea exclusivamente imputable a la persona que hubiere cometido tal infracción y, en lo demás, habiendo adoptado X todas las medidas razonablemente exigibles, y adecuadas para el control de la información confidencial recibida. Para este último caso, Y en este acto se subroga desde ahora y para tal supuesto, y X presta su conformidad, en todas las acciones que pudieran corresponder a X encaminadas a exigir al autor de la violación las responsabilidades civiles y penales que, en su caso, procediesen."

But as we have said, it is common for the clause to require the recipient contracting party to obtain signature of a specific undertaking of confidentiality from recipient third parties in such a way as to bring them, too, into a contractual net:

- "Licensee will obtain similar written agreements from its employees to whom such information is disclosed."
- "Each member shall impose the same confidentiality obligations . . . upon its affiliates, subcontractors, vendors and other third parties who are in association with it and may have access to any confidential information during the term of this agreement."
- "Le licencié fera signer à ces tiers fournisseurs ou sous-traitants un engagement de garder secrètes les dites connaissances techniques transmises dans le cadre de ce contrat."
- "Seller agrees that each of its employees having such need to know shall execute a secrecy agreement having equivalent terms and conditions to those set forth in this Article . . . and naming Buyer as intended third party beneficiary."

The view is sometimes taken that the general provisions of an employment contract should be recognized as adequate and sufficient:

> "The Receiving Party shall bind its employees and/or delegates having access to the Information by adequate secrecy agreements. The Owner expressly acknowledges that the standard terms of the contracts of employment between the Receiving Party and its employees contain an adequate secrecy agreement."

2. The persons to whom the information is transmitted are thus invited to provide a personal undertaking of confidentiality.[49]

If a member of staff is concerned, the commitment may already be provided, as has already been mentioned, by a general clause written into the employment contract itself. Here is an example of such a provision:

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[49] On this point, cf. also J. Jehl, *op. cit.*, p. 170; J. Huet & F. Toubol, *op. cit.*, No. 30.

"The Executive shall not during his employment hereunder (save in the proper course thereof) or at any time after its termination for any reason whatsoever disclose . . . any confidential or secret information which he has or may in the course of his employment hereunder become possessed relating to the Company or its Associated Companies or any of its or their suppliers, agents, distributors or customers . . ."

Upon entry into employment with the firm, the employee is sometimes required to enter a separate confidentiality undertaking drafted in much more detail.

In general, the provider of confidential data insists on a more specific undertaking that requires the adherence of the members of staff to the confidentiality clause in the contract by virtue of which the information has been transmitted or which reproduces its terms. Such a requirement may be set out as follows:

"We, the undersigned, hereby declare that we belong to the personnel of . . . as . . . and that we have read the agreement signed by . . . dated . . . concerning the secrecy obligations. We further indicate that considering their economic value as such, all information and documents relating to the Process shall not at any time be . . . divulged except for the purposes of this preliminary agreement or for those of some subsequent agreement between the parties hereto."[50]

But for whose benefit is this undertaking provided? The employer or the initial provider of the data? Both solutions appear in practice, but the terms used are not always clear on this point.

A clause quoted above required the designation of the provider as the third-party beneficiary of the undertaking by the employee. In French law, such phrasing creates an obligation by the employee toward his employer, accompanied by a stipulation "for the benefit of a third party" as concerns the original provider. We will return later to these delicate legal problems.[51]

The following example leaves no room for doubt. The undertaking is directly provided by the employee in favor of the provider of the data:

"Il est prévu que le soussigné . . . demeurant . . . participe à une intervention de son employeur, la société . . . International (France) S.A. auprès de la société X, dans le cadre d'un contrat de prestations de services informatiques.

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[50] Clause taken from J.M. Deleuze, *op. cit.*, pp. 37–38.

[51] Cf. *infra*, pp. 289–290.

"Le soussigné s'engage personnellement par le présent document vis-à-vis de la société X, qui accepte, au secret sur les informations qui viendront à sa connaissance dans le cadre de son intervention. Tous les renseignements qui lui seront fournis, tous les documents qui lui seront confiés ou qu'il élaborera dans le cadre de son intervention, tous les entretiens auxquels il participera seront considérés par lui comme confidentiels.

"Il reconnaît que son attention a été attirée sur le caractère particulièrement sensible des informations sur les recherches, les procédés techniques et de fabrication, les systèmes d'information et les logiciels informatiques de la société X et des sociétés du Groupe.

"Sauf autorisation expresse, il ne communiquera pas à des tiers des documents, études, logiciels, etc. visés par le présent engagement. De même, il n'en conservera pas par-devers lui au-delà de son intervention, sauf autorisation expresse et écrite.

"Font exception au présent engagement . . .

"Cet engagement est valable pour la durée de l'intervention du soussigné et les vingt années suivantes. Il ne sera pas modifié par un éventuel changement d'employeur du soussigné.

"Fait en deux exemplaires, dont un a été remis au soussigné."

The data, as we have seen, may also be transmitted to certain persons who are not employed by the initial promissor of confidentiality. Such persons may also be required to enter into specific confidentiality undertakings.

It can happen that the roles are reversed. In the period of negotiations, confidential information is sometimes provided initially to someone sent by the firm showing interest, for example, a specialized technician or an accountant, in order to permit that person to render an opinion in very general terms ("the process is interesting," "the financial situation is healthy," etc.). The emissary is required to enter into a confidentiality undertaking not to reveal the information even to his own company, the latter being required to recognize that undertaking! Here are examples of two documents of this type:

A pledge by the emissary:

"Je maintiendrai secrètes ces informations reçues sur base de la confiance qui m'est accordée . . . et je m'abstiendrai de les . . . divulguer à des tiers y compris ma propre société dans la mesure où elles dépasseraient le domaine des généralités."

Related undertaking by the company:

"Nous . . . déclarons avoir reçu une copie de l'engagement signé par M . . . et relatif aux informations que nous l'avons chargé de recevoir de X . . . Nous déclarons ratifier celui-ci et en faire nôtres les clauses y continues. . . .[52]

3. A very delicate problem arises with respect to the transfer to a third party of a contract containing a confidentiality clause, either through a specific transfer or in the event of the takeover of the promissor company (we will treat as similar the taking of a sufficiently large share interest[53]). In some cases, there is no difficulty that the transferee company should succeed to the rights and obligations of the transferor and hence to the obligation of confidentiality, if such transfer can be achieved in accordance with the requirements of the applicable law. But it is otherwise in different cases, in particular, if the contract is assigned to a direct competitor of the party who provided the confidential information, or if the promissor should fall under the control of such a competitor of the promissee.[54]

Rare are those confidentiality clauses that address this problem. Here, however are two examples:

- "This agreement may not be assigned by you without our prior agreement in writing."
- "The agreement shall inure to the benefit of each of the Parties and may not be assigned in whole or in part by either Party without the prior consent of the other Party, except that each Party's interest shall be assignable without the consent of the other in pursuance of any merger, consolidation or reorganisation or voluntary sale or transfer of all or substantially all the assigned Party's assets where the merged, consolidated or reorganised corporation or entity resulting therefrom or the transfer of such sale or transfer has the authority and power effectively to perform that Party's obligations to the other under this Agreement."

[52] Examples given by J.M. Deleuze, *op. cit.*, pp. 138–139.

[53] Similar problems arise when public companies are privatized and their activities are taken oven by private companies.

[54] A similar situation appears in consortia, when a defaulting company, replaced by a newcomer, is compelled to leave its know-how at the group's disposal, while it does not participate any more to the benefits of the operation (a different, but equally problematic, situation occurs when a firm voluntarily withdraws from a group after binding the members by a confidentiality and non-use undertaking in relation to the information it has transferred, and then that firm transfers its knowledge to a rival group).

One will note that the second clause sees no difficulty in transferring responsibilities resulting from a total transfer of the business, thus not addressing the two concerns expressed above.

A solution may be found by combining another clause of the contract, which envisages that it may be terminated in the event of transfer or, change in the control of the other contracting party, with the provision for the confidentiality obligation to survive the contract.[55] One should not underestimate, however, the difficulty in supervising the implementation of the proposed technique under such circumstances.

4. The Intensity of the Obligation—Steps to Be Taken

(a) The promissor under a confidentiality undertaking is obliged to keep a secret but what is the intensity of his obligation? Is he obliged to offer an absolute guarantee that the information will not be revealed, or may he rely, in the case of disclosure, on certain grounds for exoneration, or does he only undertake a less demanding obligation, for example, merely to do "his best" to keep the information confidential? We return here to the distinction between obligations by way of guarantee, obligations to reach a specific result and obligations as to appropriate means (*obligations de garantie, de résultat* and *de moyens*), which originate in French law but are present in the same form or more implicitly in many other legal systems. This problem concerning the "intensity" of the obligation has been discussed more thoroughly in the preceding chapter on best efforts clauses.[56] Such questions also arise in connection with confidentiality obligations.

Some clauses appear to impose absolute obligations:

- "X will hold (the Information) in strict confidence and will not disclose it to any person."
- "The Information shall be retained in the strictest confidence and shall not without the express prior written consent of the initial supplier of the Information be disclosed or divulged to anyone . . ."
- "El licenciatário deberá tratar la información, materiales y Know-how que le han sido facilitado por medio de este contrato con la más estricta confidencialidad. . . ."

But in other examples, the expressions used appear less strict:

- "Each member shall use its best efforts to keep in strict confidence . . . all commercial and technical information . . . acquired by it . . ."

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[55] On this point, cf. *infra*, Chapters 11 and 13.

[56] Cf. *supra*, Chapter 4.

- "The Licensor and the Licensee further agree and covenant . . . to use due diligence to protect . . . the Know-how furnished hereunder during the term of this Agreement."
- "The Company agrees that . . . it will take reasonable steps not to disclose . . . to any third parties."
- "Le licencié s'engage expressément . . . à prendre toutes les précautions raisonnables pour qu'aucune information ne soit transmise à des personnes non spécialement autorisées par le concédant."
- "Both parties shall use all reasonable efforts to maintain in confidence the fact that Recipient and X have entered into discussions referenced above, the subject of such discussions and the terms and conditions of this 'Agreement' as well as any other 'Agreement' to be entered into by them."

A formula seen more than once adopts as a criterion the standards used by the promissor himself for his own business:

- "Each party shall use the same efforts to maintain confidential and to prevent disclosure of . . . as such party uses to maintain confidential and prevent the disclosure of its own proprietary information or trade secrets of a similar nature."
- "Chaque partie . . . prendra vis-à-vis des informations confidentielles qu'elle reçoit ou obtient de l'autre partie les mêmes mesures qu'elle-même prend vis-à-vis de ses propres informations confidentielles pour en empêcher la publication, la divulgation et la communication à des tiers."
- "Toutes les données confidentlelles relatives à l'entreprise de l'utilisateur et qui seraient remises à l'Université, pour l'exécution du présent contrat, seront protégées par elle dans la même mesure qu'elle protège ses propres données."

Needless to say, one should not accept such a clause before being informed of the way the other enterprise is managed.

Other clauses make use of a combination of criteria:

- "The Proprietary Information received from Y shall be protected and kept in strict confidence by X which must use the same degree of precaution and safeguards as it uses to protect its own Proprietary Information of like importance, but in no case any less than reasonable care."
- "X shall not be liable for the inadvertent or accidental disclosure of information if such disclosure occurs despite the exercise of the same degree of care as it normally takes to preserve its own proprietary information of a similar nature supplemented by the extraordinary care specified in Paragraph 1 hereof."

The first paragraph of this clause, after stating the obligation of confidentiality, lists various steps to be taken, in particular as concerns copies and communications to staff and certain third parties.

One may be surprised at the relative laxity of these expressions. Should not a confidentiality undertaking be expressed in terms of an obligation to achieve a specific result (*obligation de résultat*)? As one commentator emphasizes, this weakening of the rigor expected can be explained by a realistic attitude. The provider of data may himself, within its own enterprise, have had experience of the difficulties of keeping a secret. It is not wise to insist on more than the promissor can reasonably achieve.[57]

(b) It is significant that different formulae are sometimes used according to whether it concerns keeping the secret oneself or causing it to be kept by others:

> "Smith agrees:
>
> "(1) That it will not disclose (except to a subsidiary or affiliate of Smith), or commit any act or omission that would impair or depreciate the confidential nature or value of, and
>
> "(2) That it will use its best endeavours to prevent any subsidiary or affiliate of Smith from disclosing . . ."

Even as concerns staff, flexible formulae are common:

- "We shall . . . take such steps as may be reasonably desirable to enforce such obligations."
- "Chaque partie prendra toutes les mesures raisonnables pour s'assurer que les dites connaissances techniques provenant de l'autre soient traitées comme secrètes par les membres de son personnel ou de celui de ses filiales et ne soient divulguées."
- "Chaque partie prendra vis-à-vis de son personnel les garanties habituelles prévues dans l'industrie pour éviter toutes divulgations . . ."

Some clauses, however, stipulate more strictly:

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[57] J. Jehl, *op. cit.*, p. 169.

J. Huet & F. Toubol (*op. cit.*, No. 34) apparently have no hesitation to state that the promissor of a confidentiality undertaking is necessarily under an *obligation de résultat.* Most of the clauses cited above seem to contradict such analysis. O. Capatina, (*op. cit.*, No. 6) considers that an undertaking not to disclose normally possesses the features of an *obligation de résultat* but that parties may define it as an obligation as to the appropriate means.

"You further agree to vigorously enforce, at your expense, such agreement . . ."

It may prove difficult in certain cases to obtain the specific secrecy undertaking from third parties by reason of the number of people involved or the sensitivity of certain contracting parties.[58] The obligation to obtain such commitment is therefore softened.

- ". . . wherever reasonably practicable, X shall obtain a written statement from each of its employees having access to the Proprietary Information to maintain the same confidential . . ."
- "X shall procure that all employees, consultants and sub-contractors involved with the Commercial Development Programme shall be subject to the same obligations of confidence . . . and shall enter into a suitable secrecy agreement in a form approved by Y, or, where or insofar as this is not reasonably practicable, X shall take all reasonable steps to ensure that any such employees, consultants and subcontractors having access to any of the Know How are made aware of the obligations of confidence attached hereto."

(c) The obligation is sometimes expressed by reference to the measures to be taken with a view to keeping the data confidential:[59]

- "Les parties s'engagent à prendre toutes dispositions appropriées en vue d'éviter la divulgation du know-how."
- "El licenciatário deberá . . . tomar todas las mesuras necesárias para evitar la filtración de los conocimientos hacia terceras partes . . ."

These measures are sometimes the subject of detailed instructions.

1. Certain formulations concern the location of the confidential information, and the restriction of access to the data:

- "You shall keep a record of each location of the Information . . ."
- "X shall keep all documents and any other material bearing or incorporating any of the Proprietary Information at the usual place of business of . . . as given above."
- "I undertake to ensure that any documents which are in my possession will be safeguarded and will be kept in a locked place to which free access is not available."

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[58] The measure is psychologically impossible in cases where the third party is already bound to secret by professional status. One cannot imagine, for instance, to require such an undertaking from a barrister.

[59] On this aspect, also see G. Hertig, *op. cit.*, p. 222; J. Huet & F. Toubol, *op. cit.*, p. 32; O. Capatina, *op. cit.*, No. 6.

- "X shall not store, record or otherwise retain any information at any time on any computing or other equipment which is connected to any telecommunications system except for communications relating to . . . 's interest in possible licensing under inventors rights."

2. Concern is sometimes expressed to avoid any mixing:

- "X shall keep separate all Proprietary Information and all information generated by . . . based thereon from all other records, documents, drawings files and the like."
- "Each of the Parties undertakes to use all due diligence to keep all such Intellectual Property hereunder as separately identifiable items properly secured and adequately protected and as the proprietary and confidential property of the furnishing Party and further undertakes that any integration or incorporation of the same with Intellectual Property belonging to the receiving Party shall only be done on the basis that such integrated combined or intermingled Intellectual Property shall not be disclosed or communicated to any third party without the consent of the furnishing Party, which shall not unreasonably be withheld."

3. Walls have ears. Indiscretions may be involuntary. This is pointed out by the following clause taken from an employment contract:

> "Business matters should not be discussed in public places, including for this purpose our own staff restaurants, or where they can be overheard. Care should be exercised even in the corridors and lifts of our own offices."

4. The same contract also expresses concern about avoiding involuntary written indiscretions:

> "The use of code or other names or combinations of names (which may give an indication that an important or substantial transaction is pending) should be avoided in anything that will have general circulation—in particular in luncheon lists."

5. The problem of copies of documents constitutes a *leitmotiv* in those clauses that set out the steps to be taken.[60]

[60] On the problem of copies in contracts in the computer field, cf. Y. Poullet, *op. cit.*, pp. 957–959.

In some cases, all copying is forbidden:

- "Consultant agrees that he shall not make any copies whatsoever of Proprietary Information."
- "I undertake not to take copies of such documents and not to permit others to do so."

More generally, copying is limited to that strictly necessary and/or made subject to the agreement of the other contracting party:

- "X shall . . . make copies of the Proprietary Information only to the extent that the same is strictly required for the purposes of its evaluation by . . ."
- "Le preneur de licence mettra tout en œuvre pour éviter que des informations confidentielles ne soient dupliquées ou portées à la connaissance d'autrui, en dehors du cas prévu sous le paragraphe 5 (back-up)."
- "We will not without prior written consent make any notes, sketches, drawings or photographs or in any other way whatsoever copy the Information . . ."

The following clauses are particularly detailed as to the making of copies:

- "We will make no more copies of the Information than is essential for the agreed purposes and will make and maintain a register of the information and each copy thereof or part thereof showing the custody and whereabouts of each copy. We will provide you with a copy of such register at intervals of . . . and will permit you to inspect the register at any reasonable time."
- "The parties agree that Information disclosed is and will remain the property of the disclosing party, and that drawings or other written or printed data included therein are not to be copied or reproduced, mechanically or otherwise, without the express written permission of the disclosing party, except for such copies as the receiving party requires for internal circulation for evaluation purposes. The parties agree that the receiving party may keep all Information disclosed for 90 days for purposes of evaluation. After such time the originals and all copies of such drawings and other written data, except one copy for the Legal Department files, and any samples and devices are to be returned within 20 days after request by the disclosing party, unless otherwise agreed in writing by the disclosing party. The disclosing party agrees to archive one complete set of the disclosed Information."

It is hardly necessary to point out that the checking of compliance with these provisions can be particularly difficult.

6. Some clauses make cumulative use of several of these various ideas adding obligations as concerns compliance with secrecy by members of staff and concluding the list with a formula of general application such as the following:

> "In addition to the foregoing stipulations of this article, the Recipient shall take every other possible measure reasonably open to it to prevent the Proprietary Information from being made available to any third party."

7. The penultimate example touched on yet another aspect of the steps envisaged to protect confidentiality. Clauses sometimes express concern over the use of documents containing the information in the event of a breakdown in negotiations or the termination of the contract. Commonly, provisions provide for the return or destruction of documents. One finds various references to copies. Here are a few examples:

- "In the event discussions with respect to a possible acquisition of the Business or other transaction with ABC are terminated, upon ABC's request the portion of the information furnished or made available to you or your representatives by ABC or any of its representatives shall be returned to ABC without your retaining copies thereof and all other Information will be destroyed without your retaining copies thereof. Such determination will be confirmed in writing by an officer of the Company."
- "On completion or earlier termination of the Agreement unless otherwise agreed each party shall return to the other the secret technical documents and information that have been provided to it by the other party together with any copies thereof, and upon request also return all other technical documents and information provided by the other party under the Agreement."

It is sometimes allowed to keep a single copy, for purposes of archiving, or more particularly, in case of possible later litigation:

- "Y agrees to return all but one file copy of Proprietary Information upon written request by . . ."
- Upon termination of this Agreement, Engineer shall return . . . all business and technical information received . . . except that in accordance with usual practice Engineer shall be entitled to retain one copy thereof for its record purposes only."

- "The Receiving Party agrees that . . . it will promptly return or destroy (with such destruction to be certified to the Disclosing Party) all Evaluation Material disclosed to it, without retaining any copy thereof, except that one copy of such Evaluation Material . . . may be retained in the legal files of the Receiving Party . . . for the purpose of defending or maintainng any litigation relating to this Agreement or such Evaluation Material."

The destruction of documents may be envisaged during the course of the contract, as in this clause taken from an employment contract:

> "Confidential documents and drafts which are no longer required should be shredded or thoroughly torn up."

Some clauses take care to deal not only with the documents provided to the other contracting party but also those that the latter creates on the basis of information provided:

- "All written material, including but not limited to worksheets, test reports, manuals, lists, memoranda, either furnished to Seller by Buyer directly or indirectly or prepared by Seller, containing data and information referred to in Section 9.1 above shall remain or become the property of Buyer and shall be returned and/or given to Buyer at the expiration or termination of the Service Period."
- "Upon the termination of my employment with the Company, I shall deliver to the Company all documents which contain any Confidential Information which are in my possession, including all copies thereof, whether the same were prepared by me or others."

An interesting system may be organized for the documents drawn up by the promissor himself:

> "All Information, except for that portion of the Information which consists of analyses, compilations, studies or other documents prepared by us, or by our Representatives, will be returned to you immediately upon your request and we agree not to retain any copies, extracts or other reproductions in whole or in part. Information which consists of analyses, compilations, studies or other documents prepared by us, or by our Representatives, will be held by us and kept confidential and subject to the terms of this Agreement, and destroyed upon your request."

Here is a clause that extends the obligation to return the documents to copies made by a third party:

"When submitting your bid to us you will return to us all Technical Information received from us along with any and all copies thereof made or acquired by you and your sub-contractors."

The following example envisages the return or destruction of documents "at any time":

"At any time the Recipient will return all Confidential Information received from X hereunder, Including all copies thereof, or destroy same and certify in writing to X that all Confidential Information has been destroyed."

Some skepticism may be justified as to the strictness of the obligations to return. The example below betrays such fears:

"In the event that this Agreement terminated pursuant to the provisions of Section 6, X and Y shall each use all reasonable efforts to collect and return to the other any and all blueprints, drawings, written reports, letters or memoranda or notes which have been received from or contain information received from the other under the provisions of this Agreement or relating thereto."

The return or destruction of documents does not put an end to the obligation of confidentiality. It may be as well to point this out:

"Notwithstanding the return or destruction of any Material, you will continue to be bound by your obligations of confidentiality and other obligations hereunder."

5. Duration

(a) The confidentiality obligation is, more often than not, limited in time.

In many cases, it carries a fixed duration. The periods met, in practice, are extremely variable. Relatively short periods of 12 to 18 months are found in some cases, in particular, as concerns data in an application for a patent; confidentiality is only justified during the period of the application. An inventor may also promise not to reveal the process to any third party during the brief period of an option granted to a firm that is considering a licence. More often, however, the periods envisaged are much longer easily extending to up to ten or 20 years.[61]

The starting point of these periods varies from clause to clause.

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[61] About the usual length of such periods, also see J. Jehl, *op. cit.*, pp. 170–171.

Frequently, the period starts from the disclosure of the secret:

- "The obligations of this Part V shall, with respect to each item of information, continue for four (4) years after the disclosure of such item of information from one party to the other."
- "For a period of ten years after the date of disclosure hereunder . . ."

Some periods run from the date of the making of the contract, perhaps an easier date to use when it comes to the question of proof:

> "X sera délié de l'engagement de confidentialité au bout de 18 mois aprés la signature du présent accord en ce qui concerne le caractère confidentiel des informations reçues."

Other starting points can be chosen. Thus an obligation may apply:

- ". . . until five years after the start of commercial use of the project,"
- ". . . pendant toute la durée du présent contrat, plus une période additionnelle de sept ans."
- ". . . until five years after X shall have completed the work provided for in article 9b."

The use of a starting point, which is delayed, clearly extends the period of the confidentiality obligation.[62]

Confidentiality clauses entered into during negotiations may draw distinctions as to the period of the obligation according to whether agreement is reached or not. Here is an example of a proposed acquisition of shares in the capital of a company:

> "La obligación de confidencialidad asumida por X de acuerdo con las stipulaciones anteriores y, en consecuencia, la obligación del pago de une indemnización alzada o, en su caso, de los daños efectivamente sufridos, a que se obliga X de acuerdo con lo dispuesto en la cláusula anterior, será mantenida por X hasta la fecha en que tenga lugar la adquisición por X de la participación en el capital social de . . . En el supuesto de que dicha adquisición no tuviese finalmente lugar, obligación de confidencialidad y la garantiá que respecto de la misma presta se mantendrán efectivas por un periodo máximo de cinco años, excepto en aquellos casos en que la información confidencial perdiese obviamente tal carácter por darse alguno de los supuestos a que se refieren los números 3 y 4 de la cláusula primera."

[62] The duration of the undertaking can also be determined by reference to a date *ad quem*, as in the following clause: "The present undertaking will remain in force until June 30, 2008."

This clause, drafted with care, seeks to control at the same time the effect of the penalty clause, which punishes breaches of confidentiality and it specifies that the obligations shall end before their natural term if the information ceases to be confidential.

(b) Confidentiality clauses often belong to that group of undertakings that survive the contract, the subject of another chapter of this book.[63] The need for discretion can remain as important as ever after the expiry of the contract that gave rise to the disclosure. An ex-licensee, an ex-distributor, an ex-employee must remain just as respectful of the confidentiality of information received as they had to be during the course of their collaboration.

The fixing of a specific period for the confidentiality obligation, extending beyond the end of the contract, is an expression of this concern. It is often said explicitly that this obligation survives the contract so as to avoid any doubt in the event the contract should be prematurely terminated:

- "The obligations of the licensee under this article shall survive the termination of this agreement."
- "Diese Verpflichtung gilt auch für die Zeit nach Beendigung des Vertragsverhältnisses."
- "The purchaser and Contractor hereby agree that the obligations contained in this Article . . . shall not be affected by a Termination and/or Cancellation of this Contract under Article 33 herein."
- "A's obligations under this Article . . . , in spite of termination of this Agreement for any cause, shall continue until twenty (20) years from the Effective Date."
- "The terms and conditions of this Confidentiality Agreement shall continue in force without limitation for a period of ten (10) years from the date hereof unless and until it is superseded by express written provision to the contrary in any definitive agreement between PARENT . . . and you for the sale and purchase of the business . . ."

(c) Some duration provisions return to questions already examined above. Thus, data, which were already in the public domain when they were transmitted, are excluded from the confidentiality obligation. It is often stipulated that the obligation ceases when the data enter public domain during the course of the contract. The Spanish clause quoted is an illustration and let us consider from this aspect another example:

". . . unless and to the extent such information is or later becomes generally available to the public."

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[63] Cf. *infra*, Chapter 8.

It is the same, *mutatis mutandis*, for information received lawfully from a third party:

> "Le présent engagement ne s'appliquera pas aux informations dont vous pourriez établir . . . qu'elles vous ont été communiquées ultérieurement par un tiers pouvant le faire licitement et sans restriction quant à l'usage ou au caractère confidentiel des dites informations."

In such cases, the confidentiality obligation is terminated prematurely as to information that has come into public domain or has been revealed by a third party in such circumstances.

(d) Expiry of the stipulated period terminates the confidentiality obligation. The effect is automatic as a matter of law, but certain clauses state it expressly:

> "A l'expiration de la période de trois ans définie ci-dessus, chaque partie n'aura plus aucune obligation de quelque nature que ce soit à l'égard de l'autre partie en ce qui concerne les informations confidentielles de cette dernière, et sera donc libre de les publier, de les divulguer et de les communiquer à des tiers sans aucune restriction . . ."

(e) Certain confidentiality obligations have an undefined period of application, as with the two following clauses:

- "I shall not . . . disclose any Confidential Information, both during my employment with the Company and at any time thereafter . . ."
- "X shall, at all times during and after expiry or termination of this Agreement, keep secret and confidential . . ."[64]

Similar clauses may refrain from indicating any duration for the confidentiality obligations. While such clauses are rare, they do exist.

Indeterminate undertakings may nevertheless come to an end when the information comes into public domain or by the application of a similar exception.[64]

(f) The duration of confidentiality obligations gives rise to certain problems of legality.[66]

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[64] Cf. also the clause under dispute in the case decided by the Tribunal de Grande Instance of Quimper on May 9, 1986, *Rev. Dr. Propr. Ind.*, 1986, p. 80.

[65] Cf. *supra*, pp. 247–255.

[66] Cf. *infra*, pp. 291–293.

6. Remedies

(a) It is rare to find confidentiality clauses that provide specific sanctions. This may result from the fact that the parties have not seen any need to provide particular remedies being satisfied with the sanctions provided by the law generally or those that the contract may have provided unspecifically. This lack may also reveal a certain skepticism as to the ability of enforcing compliance with a confidentiality undertaking.

(b) Some clauses limit themselves to affirming the liability of the party in default without providing any particular sanctions. In addition to the examples already cited, here is another one:

> "It is understood that you shall be responsible for any breach of these obligations by any of your officers, directors, employees or professional advisors."

(c) Some clauses, among the samples we studied, envisage nevertheless the possibility of damages:[67]

- "In the event of any breach of the secrecy provisions set forth in Article 13.1 due to negligence, the party in breach shall indemnify the other party for any loss or damage caused to such other party during the term of this Agreement."
- "En cas de non respect de ces clauses de confidentialité, la société se réserve le droit de réclamer des dommages et intérêts pour le préjudice subi."
- "Due to the economic value of these documents and information in general and for you, I will indemnify you against any loss arising out of the breach of this undertaking."

Such clauses may become very detailed:

> "4.1A In the event that the Recipient becomes or is deemed to become in default of any of its obligations hereunder, the Recipient shall assume any and all responsibilities and liabilities therefore, and shall satisfy all claims and demands made arising therefrom whether made by the Company or by a third party against the Recipient and/or the Company and indemnify the Company from any and all cost, charge, expenses, damage and loss (reasonably) incurred or suffered by the Company together with any (reasonable) additional expenditures and from any and all claims, damages, compensation and other liabilities for which the Company may become legally liable contractually or otherwise.

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[67] On damages for breach of confidentiality, also see Ter Kah Leng & S. HS Leong, Contractual Protection of Business Confidence, *Journ. Bus. Law*, 2002, pp. 513–538.

"4.1B It is recognised that the Proprietary Information is derived from third parties in addition to the Company and that in the event of a breach of this Agreement by the Recipient the Recipient may be liable in damages to such third parties as well as to the Company and/or to compensate the Company for any liability it may have to such third parties for unauthorised disclosure of any part of the Proprietary Information."

This clause seeks to cover the various hypothetical possibilities of action and various types of damage. It does not, however, resolve the most delicate problem, that of the calculation of loss. The damage resulting from a breach of secrecy is indeed very difficult to establish.[68] The following clause entrusts this duty to arbitration:

"Toute violation de l'une quelconque des dispositions du présent accord par B ou son personnel, donnera lieu à dommages et intérêts en faveur de A, ceux-ci étant fixés par voie d'arbitrage conformément au paragraphe 8 ci-après."

Faced with this difficulty, the provision of a penalty clause is to be recommended,[69] as in the following examples:

- "Fur jeden Fall der Zuwiderhandlung gegen die Verpflichtung in Ziffer 2 unterwirft sich der Unterzeichnende einer sofort fälligen Vertragsstrafe in Hohe von DM . . ."
- "In the event that a party should commit a breach of his undertaking under this Article, he shall be liable to pay to the other parties for each breach a penalty of two hundred and fifty thousand Mexican Pesos ($250,000.00 Mex. Cy). provided always however

[68] Cf. on this point G. Hertig, *op. cit.*, p. 223; J. Huet & F. Toubol, *op. cit.*, No. 35. Cf. the very interesting decision of the Tribunal de Grande Instance of Quimper of May 9, 1986, already cited (*Rev. Dr. Propr. Ind.*, 1986, 80). Researchers under contract had published the results of their work, in spite of a confidentiality clause. The tribunal named an expert to determine whether the publication of the article had led to a disclosure apt to prevent the claimant from taking a patent, and, if so, to appraise the resulting loss. On the other hand, the tribunal considered as "purely hypothetical" the loss alleged by claimant, namely that the publication could incite competitors to develop similar equipment, thus giving them a technological edge to the detriment of claimant's market share. In another case also referred to above (Paris, February 14, 1997, *Jur. Class. Pér.*, éd. gén., Jan. 7, 1998, 25, note B. FAGES), determination of the loss proved to be easy. Information concerning Princess Diana, which had been submitted under a confidentiality clause, was published in another periodical in spite of that undertaking. It happened that the victim had sold the information to that periodical where the publication appeared, and that periodical, under the circumstances, greatly reduced the victim's remuneration. Damages were granted for the amount of the loss.

[69] Cf. G. Hertig, *op. cit.*, p. 230; J. Huet & F. Toubol, *op. cit.*, No. 35.

that the other parties may claim larger damages upon proof that the real injury was greater than the amount of such penalty."

This last clause has the inconvenience of putting in doubt the lump-sum character that normally applies to a penalty clause by permitting the proof of higher levels of damages.

Although the Group's sample did not include any examples, the payment of the amount arising under such penalty clauses might be ensured by a cash deposit or a bank guarantee.[70]

(d) Other clauses are more explicit as to the remedies available to sanction indiscretions. One notices, particularly, mention of the possibility of obtaining an injunction from a court.

- "Without prejudice to the rights and remedies otherwise available to you, you shall be entitled to equitable relief by way of injunction if we or any of our Representatives breach or threaten to breach any of the provisions of this Agreement."
- "In the event I violate any terms of this Agreement it is understood and agreed that such violation will cause immediate and irreparable harm to the Company for which there is no adequate remedy at law and that the Company shall be entitled to an injunction issued by any competent court of equity, enjoining and restraining me and each and every other person concerned therein from the continuation of said violation and the Company shall also be entitled to full compensation by me for any damages sustained by the Company as a result of said violation and for any legal costs including reasonable attorney's fees incurred by the Company in obtaining same."
- "It is further understood and agreed that money damages would not be a sufficient remedy for any breach of this Agreement and that the Company shall be entitled to specific performance and injunctive or other equitable relief as a remedy for any such breach. Such remedy shall not be deemed to be the exclusive remedy for breach of this Agreement but shall be in addition to all other remedies available at law or equity to the Company."

Clearly, these clauses are taken from the context of common law; one finds in them various references to the remedies of equity. Analogous provisions, *mutatis mutandis,* could be found in civil law, providing for the possibility of acting *en référé* in order to end indiscretions (but is there any need for an express clause to provide for such a remedy when it is already avail-

[70] Cf. also G. Hertig, *id.*, pp. 230–231.

able?), and other remedies such as, according to the circumstances, an action for specific performance or for damages. An express termination clause is also of value under legal systems that make termination for non-performance a matter subject to a court decision.

One will appreciate the value of the different remedies available depending on the circumstances. An injunction to cease doing something only makes sense if the indiscretion is not irremediable, and that the spread of the indiscretion can still be contained. Specific performance is conceivable when it is possible to take preventive measures; it has no place where the secret has already been divulged. Termination of the contract for non-performance constitutes sometimes a cure worse than the evil.

(e) Confidentiality obligations are rarely accompanied by clauses for limitation or exoneration of responsibility. An example has, however, been given above in connection with the responsibility of a company for the indiscretions committed by its own staff.[71]

(f) It would not appear necessary to emphasize that the application of sanctions presupposes the legality of the confidentiality clause itself. One should remember that certain remedies may see their validity disputed or at least subjected to judicial control.[72]

7. Limitation to the Scope of the Confidentiality Undertaking

The signing of a confidentiality agreement at the opening of negotiations should not create any ambiguity. The beneficiary may not be led to believe that this means the other party is committed to conclude a contract. Certain provisions attempt to prevent any misunderstanding:

> "This agreement shall not by implication or otherwise be construed as a grant of or a claim to a license or an option for a license. Neither shall it be construed as a claim to an exclusivity of negotiations, a contract relating to a collaboration, a joint venture, a transfer of shares or any other arrangement. Each party agrees that until a final agreement relating to the PURPOSE, neither . . . nor . . . shall be under any legal obligation and shall have no liability to the other party of any nature whatsoever with respect to the arrangements considered herein by virtue of this Agreement or otherwise except as to the confidentiality and use of the INFORMATION."

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[71] Cf. *supra*, pp. 265–266.

[72] Cf. *infra*, Chapter 6.

III. FURTHER REFLECTIONS AND CRITICAL ANALYSIS

At the end of this detailed analysis of the various elements found in confidentiality clauses, a number of more general reflections will lead us to recall that such clauses are present in a context where a duty of discretion is imposed by the law itself, by the very nature of the contract or by the application of general principles (Section III.A) and to reconsider more systematically the legal aspects of the transmission of data to third parties (Section III.B). Then we shall examine the difficult questions of the legality of confidentiality clauses (Section III.C) and their effect on the production of documents in legal proceedings (Section III.D). Finally we will examine the effectiveness of confidentiality clauses in practice (Section III.E).

A. Confidentiality Without Any Confidentiality Clause

Often confidentiality clauses provide a contractual basis for obligations that are already established by law, on the basis of legal texts, by the very nature of the contract or by the application of general principles. The national reports that follow the original report, published in 1991 in the *International Business Law Journal*, bear witness to this.

In systems as varied as those of Belgium,[73] Germany,[74] Romania,[75] England[76] and the United States,[77] laws provide penalties for the violation of manufacturing or professional secrets, of the secret character of correspondence or of certain financial information. By their very nature, certain contracts require discretion concerning one of their basic elements, the identity of one or several of the contracting parties. The agent must not reveal the name of his undisclosed principal, or the ostensible party, the identity of the person for whom he is acting; in certain types of partnership agreements (such as the French *association en participation*), the manager must remain silent as to the names of the participants.[78] Certain principles give rise to obligations for discretion in particular circumstances: *culpa in contrahendo*,[79] duty of good faith,[80] existence of a confidential relationship,[81]

[73] M. Vanwijck & M.F. De Pover, *op. cit.*

[74] W. Kraft, *op. cit.*

[75] O. Capatina, *op. cit.*

[76] P. Ellington, *op. cit.*

[77] R. Jillson, *op. cit.*

[78] M. Vanwijck & M.A. De Pover, *op. cit.*, p. 97; O. Capatina, *op. cit.*, No. 11, who stresses the differences between *commission* and *prête-nom*; the rules on *simulation* apply in the latter case (*vér. trad. en angl.*!).

[79] M. Vanwijck & M.A. De Pover, *ibid.*, pp. 95–96.

[80] *Id.*, p. 109; O. Capatina, *op. cit.*, No. 8.

[81] R. Jillson, *op. cit.*, pp. 149–150.

general sanctions for wilful acts and negligence,[82] etc.[83]

One must turn to the national reports cited in footnotes for a detailed discussion of these questions and the peculiarities and nuances inherent in each legal system. Special attention should be paid to English case law. In some cases involving former employers and persons subsequently working for new firms, it was necessary to establish to what extent the defendants might continue to utilize the knowledge they had acquired during their previous employment.[84] These decisions have enabled English judges, with their usual subtlety, to refine the concept of confidential information, and to focus on the difficulty for someone to distinguish between what he knows and may use and what he knows and may not use freely. The cases highlight the close relationship that exists between the problems of confidentiality and non-use,[85] creating the risk of transforming a secrecy clause into a clause restricting competition.

A recent development is worth mentioning. The Unidroit Principles of International Commercial Contracts have recognized the existence of an implied confidentiality undertaking related to certain information provided in the course of negotiations: "Where information is given as confidential by one party in the course of negotiations, the other party is under a duty not to disclose that information or to use it improperly for its own purposes, whether or not a contract is subsequently concluded. Where appropriate, the remedy for breach of that duty may include compensation based on the benefit received by the other party" (Article 2.16).

A similar provision appears in the Principles of European Contract Law (Article 2.302).

B. Transfer to Third Parties: Legal Aspects

In some cases, the area for stipulating obligations resulting from confidentiality commitments is well defined: a person to whom information is

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[82] W. Kraft, *op. cit.*, pp. 137–138.

[83] The Supreme Court of Canada has taken an important decision on the bases and remedies of implied confidentiality undertakings in *International Corona Resources v. Lac Minerals*, concerning revelations on the existence of an important gold deposit (*Perspectives*, vol. 2, issue 4)

[84] *Hivac Ltd. v. Park Royal Scientific Instruments Ltd.* (1946) 1 All E.R. 350; *Printers and Finishers Ltd. v. Holloway* (1964) 3 All E.R. 731; *Littlewoods Organisation Ltd. v. Harris* (1978) 1 All E.R. 1026; *Marshall (Thomas)(Experts) Ltd. v. Guinle* (1978) 3 All E.R. 193; *Faccenda Chicken Ltd. v. Fowler and others* (1986) 1 All E.R. 617. Comp. *Seager v. Copydex Ltd.* (1967) 2 All E.R. 415, which does not concern a former employee, but a firm to which an inventor had revealed one of its inventions. These decisions were submitted to the Working Group by Mr. Ronald Farrants. Some of them are commented by P. Ellington, *op. cit.*

[85] Cf. *supra*, pp. 232–233.

given promises the provider to keep the secret, not being authorized to share it with anyone. An inventor may reveal his discovery to a firm with a view to commercial exploitation and undertake not to reveal it to anyone else. Financial data may be transmitted to a tax adviser who is not entitled to divulge them at all. It is clearly established in such cases who bears the burden of the obligation of confidentiality.

It is, however, common that the secret has to be and may be retransmitted to other parties by the initial beneficiary of the revelation. We have seen confidentiality clauses that permit disclosure of the data to certain members of staff, to suppliers, to clients, to sub-contractors or to advisers.[86] In such cases, more detailed reflection is required about the obligations of each person involved and their legal nature. Clauses found, in practice, are not always very precise in this respect.[87]

To clarify the discussion, let us take a typical example and deal systematically with role allocation. Firm A has developed a process. By a licence contract concerning know-how it transmits the data, confidentially, to Firm L, the licensee. The latter is authorized to communicate the date to its technician T and its sub-contractor S. What are the effects of this arrangement?

(a) Initially L is personally bound in relation to A to keep the secret by reason of the confidentiality clause written into the licence contract under which it is the direct promissory.[88]

(b) The same clause authorizes the communication of the data to T and S. Does this give rise to particular obligations of L in relation to A in the event that T or S are subsequently indiscreet?

L may expressly or implicitly undertake certain obligations relating to the manner in which the data is transmitted to T and S: e.g., to limit the revelation to what is necessary, to give a warning of the confidential character of the information revealed, even to obtain a specific undertaking of confidentiality from the recipients.[89] L is clearly responsible towards A if he makes disclosures without complying with these terms.

Once the data have been revealed, is L obliged to assure that T and S respect the secret? As we have seen, confidentiality clauses often require this and make L personally responsible for indiscretions committed by

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[86] Cf. *supra*, pp. 255–258.

[87] This was already stated *supra*, pp. 264–270.

[88] Cf. *supra*, pp. 264–266.

[89] Cf. *supra*, pp. 266–269.

third parties to whom the secret has been transmitted.[90] Some clauses reduce the intensity of the obligations of L who may even be relieved of all responsibility in certain circumstances.[91]

What is the basis of the liability of L towards A for acts of T or S? Some of the clauses quoted above provide that L guarantees the obligations of the third parties concerned (a formula that indicates an undertaking as "surety"), or that it obtains an undertaking from the third party (*se porte-fort*—in French).[92]

Under the circumstances, the reference to a *promesse de porte-fort* is not very adequate. A *porte-fort,* in French law at least,[93] is one who undertakes to ensure that a third party enters into an obligation; it is to be distinguished from a "surety" in that, in the latter case, one is responsible for the non-performance by a third party of an undertaking already created. The *porte-fort* is released if and when the third party enters into an undertaking, while a "surety" (*caution*) obligation is created at that moment. In our context, L might *se porter-fort* for the acceptance by T and S of their own obligations of confidentiality. But once these have been entered into, the *porte-fort* has no further responsibility. It would be more satisfactory if the clauses would have required a guarantee *(caution) from L* that T and S would keep the information confidential. Such a "*caution*" would essentially guarantee the payment of damages awarded against T or S in case the secret was divulged.

However that may be, L will often be responsible, in relation to he contracting party A, for breaches by the person to whom he has delegated performance, S, and, *a fortiori,* by his employee, T, on the basis of general principles covering responsibility for the acts of a third party. One will clearly need to check the rules under the applicable law, in particular as to the possibilities that might exist for L to be released from this responsibility (e.g., because it had taken all the precautions required, as envisaged by a contract clause cited above[94]).

(c) Let us look now at the responsibility of T and S as to the confidentiality of the information that they have received.

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[90] Cf. *supra,* pp. 265–266.

[91] Cf. *supra,* pp. 266–269.

[92] Cf. *supra,* p. 265.

[93] Art. 1120 of the Civil Code. On the matter in Romanian law, cf. O. Capatina, *op. cit.,* No. 6.

[94] Cf. *supra,* pp. 265–266.

The first question is to determine who is liable: L or to A? As we have emphasized above,[95] clauses are not always precise as to this fundamental point. It is necessary to know who may bring proceedings against T or S in the event of indiscretion.

Is T held to secrecy in relation to L? If the information has been given to him ill-advisedly, without its confidential character being self-evident or without being alerted to it, T apparently is not subject to any obligation. In the opposite case, but without any express confidentiality clause, T may be bound to secrecy under legislation on the protection of industrial secrets, or even by a general secrecy clause written into his employment contract relating to confidential information that he might obtain during his employment.[96] As to S, his liability for confidentiality in relation to L, in the absence of any clause, may be deduced from certain principles, for example, in French law, that of good faith performance of agreements.

If S or T are required to enter into specific undertakings of confidentiality in the matter, it will be necessary to check whether the undertakings are at least partially for the benefit of L. As we have said, such engagements are often silent or imprecise as to the identity of the promissee or promissees of such obligations.[97]

Are T and S bound to secrecy in relation to A, assuming that they were informed of the confidential nature of the information?

Without any explicit undertaking on their part in relation to A, T and S are third parties in relation to A and their responsibility, in the event of indiscretion, could only be tortuous.[98] On the other hand, if they were required to enter a specific confidentiality obligation they will be contractually bound in relation to A in two circumstances: firstly, if the undertaking is given directly to A or, secondly, if it is given to L but with the designation of A as a third-party beneficiary (as has been discussed above[99])—at least in those legal systems that honor such provisions.

(d) Very different is the situation of a third party, X, to whom the confidentiality clause in the contract between A and L did not authorize disclosure.

[95] Cf. *supra*, pp. 267–269.

[96] Cf. *supra*, pp. 264, 266–267.

[97] Cf. *supra*, p. 267.

[98] Certain legal systems may have specific solutions. See the way French case law had developed about groups of contracts (Cass. civ., 21 juin 1988, *Dall. Sir.*, 1989, 5, note Larroumet; but cf. Cass. civ., 12 juillet 1991, *Dall. Sir.*, 1991, 549, note J. Ghestin), and the Belgian case law on immunity of agents (Cass., 7 déc. 1973, *Pas.*, 1974, I, 376).

[99] Cf. *supra*, p. 267.

If this third party gets hold of the secret by fraudulent means, for example, spying, it can become liable in tort both to L and A.

If it obtains the information in question by causing L to reveal it in breach of the confidentiality obligation entered into by the latter, the possible exposure of X in relation to A may be covered by what certain legal systems call *third-party complicity* (*tierce-complicité*) or *intentional interference in contractual relations.* For tortious responsibility of X to arise, it is at least necessary that he should have known of the existence of the secrecy clause to whose breach by A his actions have led; some national laws require additionally that X should have induced L to break his contractual obligations.[100]

(e) This brief review shows the complexity of the legal effect when a secret is transmitted to third parties. Negotiators must be extremely careful in the drafting both of clauses directly binding the original promissee to confidentiality and those that are to be entered into by third parties to whom the initial recipient has permission to disclose information.

C. Legality of Confidentiality Clauses

Freedom of contract necessarily implies a freedom in principle to create confidentiality clauses. In many cases the law itself forbids indiscretion.[101]

There exist, however, some circumstances in which an obligation of confidentiality becomes illegal.

A first example occurs when the secret is intended to hide practices that are themselves illegal. Enterprises may agree on prices or on market sharing contrary to the laws about competition.[102] A company director may undertake to provide information to third parties in breach of the rules restricting insiders (insider trading).[103]

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[100] Cf. M. Waelbroeck, Les conditions de la responsabilité du tiers complice de la violation d'une obligation contractuelle, en droit belge et en droit comparé, note under Prés. Bruxelles, March 22, 1962, *Rev. Crit. Jur. B.*, 1962, pp. 326–358.

[101] Cf. *supra*, pp. 286–287.

[102] On the dangers of a policy of secrecy in such context, cf. G. Virassamy, *op. cit.*, pp. 206–207, and the cited references.

[103] But agreements concerning certain financial operations often contain a confidentiality clause aimed at preventing insider trading. Here is an example: "You hereby acknowledge that you are aware . . . that the United States securities laws prohibit any person who has received from an issuer material, non-public information concerning the matters which are the subject of this letter from purchasing or selling securities of such issuer or from communicating such information to any other person under circumstances in which it is reasonably foreseeable that such person is likely to purchase or sell such securities."

Confidentiality clauses relating to the existence of such agreements are clearly void as are the agreements themselves.

Another situation occurs when the secrecy undertaking tends to prevent revelations to authorities who, by law, are entitled to require disclosure of certain information. The information protected may not have connections to illegal acts, as in the first instance, but its disclosure may be such as to cause higher taxation, to make public a hidden business relationship or to undermine the claims of one party in a law suit. In such cases, a secrecy undertaking is generally illegal because of the obligation to inform the authorities is mandatory, and is indeed often reinforced by penal sanctions.[104] Some members of the group even cast doubt on the legality of the straightforward obligation to warn one's partner in the event of a demand for information on the part of the authorities.[105]

A confidentiality clause may also be illegal insofar as it sometimes constitutes a restriction on competition. This is the case, particularly, for secrecy pledges that extend beyond the life of the contract, where they will prevent the promissee from continuing his activities in the specific business sector.

In truth, it is not the maintenance of the secret itself that is likely to restrict competition. That the person who has received confidential information is obliged not to reveal it to third parties, even a very long time after the expiry of the contract (on condition that the data has not fallen into the public domain), does not, in any way, change the conditions of competition.[106]

The problem arises from the frequent linking of the obligation of secrecy to an obligation of non-use. The contract provides that after expiry, the knowledge transmitted shall remain confidential, but furthermore, that it shall no longer be used. In certain cases, this combination can paralyze the future activity of the promissee, or at least oblige him to implement fundamental changes. Thus, we arrive at non-competition clauses whose legality is subject to various restrictions in different countries.[107]

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[104] Cf. *supra*, pp. 258–262.

[105] Cf. *supra*, p. 261.

[106] EEC Regulation No. 240/96 of January 31, 1996 concerning the application of Article 85, paragraph 3 of the Treaty of Rome (now Article 81, 3°) to categories of transfer of technology agreements even put at the head of its list of clauses presumed to be non-restrictive "an obligation on the licensee not to divulge the know-how communicated by the licensor"; the text added that "the licensee may be held to this obligation after the agreement has expired" (Art. 2, 1, 1). This Regulation is now superseded by EEC Regulation No. 772/2004 of April 27, 2004, which does not contain such an explicit provision any more.

[107] Cf. e.g., J.L. Bergel, Les clauses de non-concurrence en droit positif français,

Not all circumstances are the same. Particular attention is directed to ex-employees forbidden to continue to use certain knowledge acquired in the service of their former employer.[108]

It is not possible, within the limits of the present study, to consider, in more detail, the various aspects of the legality of confidentiality clauses. Draftsmen, however, need to check the validity of the clause they prepare according to the law applicable.

If the confidentiality clause is illegal, clearly it cannot be the subject of any proceedings in the event of breach, seeking, for example, to obtain an injunction or damages. This result, which is self-evident, is made explicit in the following clause:

> "It is understood that the Recipient shall be bound to enforce such undertaking of secrecy and employment only to the extent permissible under the laws of (Country X)."

Indeed, compliance with such a clause may, in certain cases, subject the parties to penalties.

D. Confidentiality Clauses and Disclosure Under Legal Procedure

What are the effects of such a contractual obligation to secrecy on the need to produce information in legal proceedings? In particular, what happens if the court requires the disclosure of information that is subject to such a clause? What are the consequences if one of the parties, voluntarily, produces confidential information to assist its defense?

A study made for the Group by J. Milquet provides part of the answer to these questions.[109] The author makes a series of relevant distinctions. In the absence of case law concerning the effect of confidentiality clauses in such circumstances, an answer must be developed from comparison with the analogous situation of banking secrecy.

Etudes offertes à A. Jauffret, pp. 21–62; Y. Serra, *La non-concurrence en matière commerciale, sociale et civile: droit interne et droit communautaire*, Paris, 1991, 337 pp.

[108] On this, cf. P. Ellington, *op. cit.*, p. 141 and the English cases cited.

As concerns transfer of technology agreements, the EEC Regulation No. 240/96 of January 31, 1996 mentioned above, no longer in force, listed among the permitted obligations "an obligation on the licensee not to exploit the licensed know-how or patents after termination of the agreement in so far as and as long as the know-how remains secret or the patents are still in force" (Art. 2.1.3).

[109] J. Milquet, La production en justice, par un cocontractant, de renseignements et de documents protégés par une clause de confidentialité, *Rev. Dr. Aff. Int.*, 1991, pp. 153–166.

From this analysis and the discussions that the Group devoted to this topic, it would appear[110] that a confidentiality clause cannot prevent the revelation of information in legal proceedings where the party concerned is required to do so (for example by means of a request for discovery, or to produce documents).[111] In such a case, its enforced disclosure should not entail contractual responsibility to the promissee, the violation of the secret being justified by "Act of Prince" or by the public interest. The party so obliged, nevertheless, assumes certain obligations. Firstly, it should seek to obtain a derogation from the obligation to reveal the information sought where such dispensation is possible (the rules requiring obligatory presentation of information in court proceedings sometimes admit such exceptions).[112] It should no doubt warn the other contracting party of the request so that the latter might take appropriate action.[113] It is obliged to limit the disclosure to the strict minimum.

On the other hand, if the promissor of a confidentiality obligation is not required by the court to produce the information in question, but wishes to do so of his own volition, in order to assist his defense against a third party,[114] such disclosure would no doubt constitute a contractual breach and involve responsibility to the promissee.

These conclusions might be influenced by the existence of means to restrict disclosure of the information revealed in court proceedings. Some procedures are public, others more or less confidential. There is sometimes a possibility of restricting disclosure of documents to the judge alone, or to have them examined by a third party, for example, a court-appointed expert, the judge as well as the expert being themselves subject to a pro-

[110] We can only submit principles of solution, the application of which will have to be made case by case according to the peculiarities of the applicable law.

[111] On the lifting of business secrets before courts under French law, cf. B. Bouloc, *op. cit.*, pp. 29–32.

[112] Cf. e.g., the recognition of a right to secrecy concerning communications between counsel and client (cf. Court of Justice of the European Communities, May 18, 1982, *E.C.R.*, 1982, 1616; E. Alexander, La correspondance de l'avocat. Confidentialité et secret professionnel. Suite et non fin, *Gaz. Pal.*, Doctr., 1998, No. 4, pp. 873–874). The Belgian law of March 1, 2000 recognizes the confidential character of the opinions given by corporate counsels to their employers, within the scope of their counseling activities; this is far from being true in other countries.

[113] It will be recalled that some members of the Group had reservations on this point. In certain cases, the obligation to warn the other party may be of dubious validity, if its effect can hinder the ongoing proceedings (cf. *supra*, p. 261).

[114] If the procedure includes opposing the parties, the confidence is already shared, but public debate may run the risk of divulging information to third parties. The possible liability of the author of the revelation will probably be affected by the parties' respective responsibilities in their dispute.

fessional obligation of secrecy. The party bound by a confidentiality obligation should seek to apply such procedures where available.

We cited several clauses relating to the forced presentation of information in the course of judicial or administrative procedures.[115] These provisions appear extremely useful as they address the duty of the parties in such circumstances and they seek to avoid dispute as to the possible liability of a party obliged to make such a disclosure.

Apart from any contentious proceedings, revelation of confidential information may also be required by public authorities. The clauses cited above recognizing this possibility[116] are less detailed than those referring to revealing information in court proceedings. This is regrettable, because the problems are similar and deserve similar attention.[117]

E. Effectiveness of Confidentiality Clauses

Are confidentiality clauses effective? Considerable skepticism was sometimes expressed at meetings of the Working Group. King Midas, in spite of the secrecy obligation imposed on his barber, was not able to prevent the wind from spreading the news of his ass's ears. Many companies, despite finely crafted clauses, will not succeed in avoiding the leaking of confidential information.

A secret is volatile, and its keeping is accompanied almost inevitably by the temptation to enlarge the circle of those knowing it. The temptation becomes quickly irresistible when the information has economic value. A confidentiality clause is difficult to enforce because it runs contrary to a strong natural tendency.

This analysis of the drafting of these clauses has furthermore shown the existence of problems at all levels, which tend to undermine the safety of the secret. One first needs to define the subject matter of the confidentiality, which is difficult to do with precision. Exceptions must be recognized for knowledge within the public domain, or already in the possession of the contracting party, or communicated to it by a third party. These exceptions give rise to problems of proof. One has to accept the secret may be shared with other people, often a great many, whose participation is indispensable; these persons must also be held to secrecy, but the risk of disclosure is clearly multiplied. One may seek to reinforce the confiden-

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[115] Cf. *supra*, pp. 258–261.

[116] Cf. *supra*, pp. 258–259.

[117] On cases where a business secret is lifted to the benefit of public administration under French law, cf. B. Bouloc, *op. cit.*, pp. 32–40.

tiality obligation by prescribing precise steps to be taken for the protection of secrecy, but how is one to control the use of copies, to police computer networks or to enforce total compliance with an obligation to return documents at the end of a contract? As for remedies, we have seen their limitations. An injunction will often come too late, and problems of proof will make it difficult to obtain adequate damages.

Certainly, the extent of the probable effectiveness of a confidentiality undertaking depends on the circumstances. Between enterprises that are mutually interested in the maintenance of secrecy, where the secret is well defined (such as a technical process) and where it is not to be shared with too many others, a clause has a good chance of being complied with. The chances diminish as the identification of the information to be protected becomes less precise (e.g., "all financial or commercial information") and in proportion to the number of people having access to it.

Maintenance of a secret may be particularly difficult among groups of companies, or even with an enterprise having several widely diversified branches. How can one stop information from filtering through to subsidiaries or from being revealed to third parties? How can one prevent the banking department of a company from divulging confidential information to the investment division? In the event of litigation, would it not be possible to claim that the subsidiary or the branch accused had already received the information from other sources? Difficulties in keeping a secret in the case of a transfer of an enterprise have also been touched upon.

The identity of the party on whom the confidentiality obligation is imposed is also important. It is scarcely realistic to count on the future discretion of a foreign trainee after his return to his own country. A university specialist, undertaking research for an enterprise, may not be very sensitive to the secret character of his discoveries and may wish to publish them in scientific journals. The presence of integrated research groups within certain firms tends to make a confidentiality obligation, obtained from them in the course of negotiations concerning a transfer of technology, quite illusory: thanks to the means of access to information currently available, these groups will often have no difficulty in re-constructing the whole process from fragmentary information already obtained.

These reasons for doubting the effectiveness of secrecy obligations result in the use of weak expressions to define the intensity of the obligation and in the frequent omission of any reference to specific remedies.

One should, therefore, not entertain too many illusions. That said, such clauses are nevertheless not absolutely useless and even greater importance attaches to drafting them better.

IV. ADVICE TO NEGOTIATORS

Whatever the doubts just expressed, a clause that is well-drafted and well adapted to its circumstances has more chance of being effective than a less perfect clause. From this study emerged a few practical recommendations.

1. A confidentiality clause must be adequately developed. A stipulation that is too laconic and expressed too broadly risks not being respected and causes difficulties in its application by reason of its gaps; it may have, for example, omitted providing an exception for information being in the public domain or the terms on which the data may be revealed to others during the course of performance. In contrast, here as elsewhere, the best is the enemy of the good. A perfectionist clause, bearing all the wrinkles mentioned in our analysis, would often risk being ill-adapted to the situation of the parties[118]—even supposing it were possible to get it accepted in negotiation. One must decide, case by case, which elements to include in the secrecy clause.
2. Against this background, one should take the following measures as appropriate:
   - The material subject to confidentiality should be defined as precisely as possible. It should be possible to identify, without any further debate, which information is subject to secrecy. One should avoid vague or pleonastic expressions in favor of objectively justifiable phrases. A certain formality is useful whenever possible (marking specific documents "confidential," etc.).
   - Excessive use of confidentiality must be avoided. An obligation to secrecy loses its impact and thereby its effectiveness when the character of secret is branded on every piece of routine information.
   - A person who receives information should be careful not to be unjustifiably put into a straight-jacket of secrecy. He will resist arrangements under which the confidential character of information is to be determined unilaterally by the other contracting party. In certain cases, he will insist on the ability to refuse to acquire certain information presented to him as confidential.
   - A secrecy clause should not fail to make an exception for certain types of information, in particular that which is within the public domain, that which is already available to the other contracting party and that which is transmitted to it lawfully by a

[118] In this respect, attention must be given to the main direction of the stream of information between partners, as well as to the manner in which the other party is managed.

third party. The notion of "public domain" should, where appropriate, be further clarified. The recipient of data should take adequate steps to be able to prove prior knowledge, e.g., by lodging, in good time with an independent third party, a list of the data already in his possession.

- The need to make information available to others should be considered in appropriate ways. This aspect of the clause deserves particular care. One should specify as precisely as possible the relevant third parties and the extent and purpose of the information that should be given to them. These persons in turn should probably be required to enter into a confidentiality obligation, but the obligation should be clear as to who should benefit. If one must bear personal liability for indiscretions committed by those third parties, one will take care to precisely define the intensity of the corresponding obligations. One should consider how to deal with the need to reveal the confidential information to some administrative authority or to produce it in a law suit, or also whether one of the parties will wish to publish the information for scientific or other purposes.
- The possibility of transfer of the promissor's business or of a change in its control should not be ignored. The provider of information will try to protect himself as best as he can against the leakage of information, perhaps by reserving the right to terminate the contract in such circumstances.
- Some specific protective steps for the data should be considered, in particular as concerns the place of safe-keeping, questions about copies or the restitution or destruction of documents at the end of the contract.
- The duration of the confidentiality obligation should be specified, always remembering that such obligations should often be continued beyond the termination of the contract. One should consider, however, the legality of such steps according to the relevant applicable law.
- Particular attention should be paid to remedies, always bearing in mind the difficulty of enforcement. A penalty clause may give additional effect to a confidentiality agreement, if appropriately accompanied by a deposit or bank guarantee.

3. In order to field any questions or help with the interpretation that might arise, it is to be recommended that the reasons and purposes for the transmission of data be set out in the clause itself, perhaps also in the recitals to the contract.

CHAPTER 6
PENALTY CLAUSES

I. INTRODUCTION

Penalty clauses are extremely common in international contracts. The Working Group was able, without any difficulty, to find a sample of over 100 of them, taken from very different types of contracts: many contracts for the construction of factories or other types of works, but also contracts for services, supply contracts, counter-trade contracts, loan contracts, licensing agreements, etc.

The subject seems perennial, but it has jumped back into the limelight in the recent past. In some countries, the legislation governing penalty clauses has been amended (in France and Belgium, for example) or there have been changes in the case law. There was a Benelux Convention on penalty clauses (never ratified), and a Council of Europe Resolution. The U.N. Commission on International Trade Law (UNCITRAL) has drawn up uniform rules on such clauses. The International Chamber of Commerce has published a practical guide on penalty and liquidated damages clauses.[1] Specific provisions are devoted to them in both the Unidroit Principles on International Commercial Contracts (Article 7.4.13) and in the Principles of European Contract Law (Article 9:509). Generally speaking, a study of penalty clauses in comparative law has much to teach us.[2]

[1] Guide to Penalty and Liquidated Damages Clauses, International Chamber of Commerce, Publication No. 478, Paris, 1990, 51 pp.

[2] For penalty clauses in comparative law, see P. Benjamin, Penalties, Liquidated Damages and Penalty Clauses in Commercial Contracts: A Comparative Study of English and Continental Law, 9 *Int. Comp. L.Q.* 1960, pp. 600–627; H. Nial, Les clauses pénales dans les contrats de vente internationaux, in *Etudes juridiques offertes à J. Julliot de la Morandière*, Paris, 1964, pp. 417–420; T. Segré, Clause pénale et dommages ultérieurs en droit comparé, *Rev. Int. Dr. Comp*, 1970, pp. 299–311; Council of Europe, *Clauses pénales en droit civil*, 3 vols of 91, 15 and 14 pp., 1972; G. Treitel, Remedies for Breach of Contract, *Int. Encycl. of Comp. Law*, 1976, Vol. VII, Chapter. 16, Nos. 120–136; J. Thilmany, Fonctions et révisibilité des clauses pénales en droit comparé, *Rev. Int. Dr. Comp.* 1980, pp. 17–54; P. Karrer, Liquidated Damages and Penalty Clauses—A Comparative Study, 1 *The Int. Contract*, 1980, pp. 225–230; D. Fischer, *Vertragsstrafe und vertragliche Schadensersatzpauschalierung*, 1981, 197 pp.; P. Murray, Comparative Analysis of Liquidated Damages and Penalty Clauses, 2, *The Int. Contract*, 1981, pp. 353–358; G. Bucksch, Rechtsvergleich zu Vertragsstrafe und/oder pauschaliertem Schadenersatz, *R.I.W.* 1984, pp. 778–782; F. Loksaier, *La clause pénale dans les contrats internes et dans les contrats internationaux*, Lausanne, 1985, 207 pp.; D.L. Jaffe & K.B. Jaffe, Stipulated Damage Provisions

Moreover, in this area as in others, systematic analysis of clauses drafted by international trade law practitioners is very fruitful owing to the diversity and originality of the techniques it reveals.

The first task is to define the subject and adopt a terminology. *A priori*, a penalty clause can be defined as one stipulating payment of a sum of money in the event of non-performance of a contractual obligation, with a purpose either of pure indemnification or of deterrence.[3] The great majority of the clauses considered by the Group come within this definition. However, occasionally, as we shall see, some of the clauses considered stray from it.[4] Furthermore, we will seek to establish the differences between penalty clauses and certain similar provisions, such as judicial penalties (*astreintes*) or withdrawal payments (*clauses de dédit*).[5]

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in France and in the United States, 33 *Amer. J. of Comp. Law*, 1985, pp. 637–672; D. Mazeaud, *La notion de clause pénale*, Paris, L.G.D.J., 1992; U. Draetta, Les clauses pénales et les pénalités dans la pratique du commerce international, *I.B.L.J.*, 1992, pp. 635 et seq.; U. Mattei, The Comparative Law and Economics of Penalty Clauses in Contracts, *Amer. Journ. of Comp. Law*, 1995, pp. 427 et seq.; B. Eggleston, *Liquidated Damages and Extensions of Time*, Londres, Blackwell, 1997; E. MacDonald, *Exemption Clauses and Unfair Terms*, Londres, Butterworths, 1999, 297 pp.; K.P. Berger, Vertragsstrafen und Schadenspauschalierungen im internationalen Wirtschaftsvertragsrecht, *R.I.W.* 1999, pp. 401–411; H. Schelhaas, Waarheen met het boetebeding in Europa? Een analyse van het Engelse, Schotse, Belgische en Nederlandse recht en de Principles of European Contract Law, *Tijdschr. voor Privaatr.*, 2000, pp. 1371–1443; A. Pinto-Monteiro, La clause pénale en Europe, in *Le contrat au début du XXIème siècle, Etudes offertes à Jacques Ghestin*, Paris, L.G.D.J., 2001, pp. 719–746.; Y. Rabier, Liquidated Damages in International Contracts for the Construction of Electric Power Stations, *I.B.L.J.*, 2003, pp. 157–169; L. Miller, Penalty Clauses in England and in France—A Comparative Study, *Int. Comp. L.Q.*, 2004, pp. 79–106.

See also a series of studies drawn up by members of the working group: H. Grigera Naon, La clause pénale en droit argentin, *D.P.C.I.*, 1982, pp. 443–445; J. Thilmany, La clause pénale en droit belge, *id.*, pp. 447–462; D. Françon, La clause pénale en droit français, *id.*, pp. 481–490; G. Schiavoni, La clause pénale en droit italien, *id.*, pp. 491–492; M. Strauch, La clause pénale en droit allemand, *id.*, pp. 499–506; L. Arentz-Hansen, International Contracts—Penalty Clause According to Norwegian Law, *id.*, pp. 493–497; B. Cremades, La clause pénale en Espagne et en Amérique Latine, *id.*, pp. 463–481; P. Ellington, Penalty Clauses in English Law, *id.*, pp. 507–514; B. Hanotiau, La clause pénale en droit américain, *id.*, pp. 515–524.

[3] The problem of defining penalty clauses will be taken up again *infra*, pp. 335–341, when they will be compared to certain similar provisions.

[4] Cf. *infra*, pp. 310–311 and 326.

[5] Cf. *infra*, pp. 335–341.

Penalty clauses also have to be distinguished from "punitive damages" which can be awarded by courts in some legal systems, but which will not be considered here; cf. B. Cremades, Liquidated Damages, Penalty Clauses and Punitive Damages within International Contracts, *I.B.L.J.*, 2002, pp. 329–345.

As regards terminology, the expression "penalty clause," in its broad meaning, will be used in this chapter, for reasons of simplicity. However, one shall be alert to the fact that certain legal systems use different expressions depending on whether the purpose of the clause is to indemnify or to punish. In English law, for example, the expression "liquidated damages" refers to clauses of the former kind, while "penalty" is used in the latter case. The distinction is important in common law countries, as penalties are considered as void while there is no doubt about the validity of liquidated damages clauses.

In the first part of the chapter (Section II), we will set out the main findings emerging from our analysis of the sample of clauses under consideration. In the second part (Section III), we will share some thoughts, first of all on the practice relating to penalty clauses in international contracts (by comparing in particular the group's observations and those of UNCITRAL) and on the main legal problems encountered in practice.

II. PRACTICE

A. Analysis

There are three possible ways of setting out the analysis. First, clauses can be considered according to the type of contract from which they are taken (for example, penalty clauses in contracts for sale, construction contracts, loan agreements, licensing agreements, etc.). Secondly, they can be classified according to the type of breached obligation that they seek to penalize (for example, clauses penalizing delay, failure to supply, inadequate performance, the breach of an undertaking not to resell, etc.). Thirdly, the different technical aspects of the clauses considered can be classified (for example, problems with the basis of calculation, rates to be applied, exempt amounts, arrangements for payment, etc.).

The second criterion appeared to be the one most likely to illustrate with clarity the practice dealing with penalty clauses in international contracts, and thus it is the one we chose. There are more similarities and shared particular characteristics among penalty clauses penalizing breaches of the same obligation, for example late performance, in different types of contract, than among penalty clauses included within the same contract, but penalizing breaches of different obligations. As for the third possibility, if we had adopted it, the minute dissection of clauses would not have revealed the sometimes very complex systems set up by those drafting the contracts.

Therefore, it is mainly according to the type of obligation to which the penalty clauses relates that our analysis will proceed. The two other criteria cannot, however, be totally disregarded. First of all, they will reappear

when we look at any sub-classifications; and they will be referred to again on several occasions in the latter part of our study.

We shall look in succession at clauses penalizing delay, inadequate performance, failure to supply, breach of an undertaking to purchase, failure to defend industrial property rights and failure to comply with certain undertakings to refrain from acting.

1. Late Performance

Failure of the duty to perform the contract on time is probably the most commonly penalized offense. It seems that this is systematically the case in building contracts, but such clauses are also frequently found in other types of agreements.

(a) Construction Contracts. Clauses penalizing late performance are extremely common in construction contracts, where they achieve the highest degree of sophistication.[6]

1. *Hypothesis—Imputability.* The hypothesis is one of delay in performance with respect to contractual obligations:

- "If the contractor fails to complete the construction supply, erection, operation, maintenance or any of them within this period stipulated in Article Twenty-Two of these conditions, or within the period fixed . . ."
- "If the contractor should fail to complete and deliver the Works and/or to render and accomplish the Services in full on the specified Dates of Completion of each contractual Task . . ."

The clause sometimes specifies that the late performance must be imputable to the party under the duty to perform:

- "Pour tout retard imputable au constructeur dans l'achèvement des travaux d'infrastructure du complexe industriel tel qu'il est prévu au planning contractuel de réalisation figurant à l'annexe G aux présentes . . ."
- "In the event that, except for reasons due to K or to force majeure, or other similar events beyond the control of A, the beginning of reception tests is delayed beyond the contractual delivery date . . ."

The following clause highlights the need for a causal link between the event allegedly constituting *force majeure* and its exculpatory effect:

[6] On this point, see also the study carried out by Th. De Galard, Les pénalities de retard dans les contrats internationaux de construction, *I.B.L.J.*, 1986, pp. 131–143.

> "Les pénalités de retard ne seront pas appliquées dans les cas de force majeure. Le cas de force majeure est seulement admis dans l'éventualité d'une répercussion obligatoire sur les délais de fourniture."

Another clause does not merely exonerate the builder in the event of late performance imputable to the client; it makes the client, in such a case, liable to the builder, which is a mere restatement of the normal legal solution:

> "Toutefois si un retard dans l'achèvement de la mission du constructeur telle qu'elle est prévue au Planning Contractuel de Réalisation était imputable exclusivement à M.O. et créait un préjudice direct pour le constructeur, M.O. indemniserait le constructeur pour le préjudice direct qu'il aurait subi."

Clearly this last clause is not a penalty clause, since it does not specify the amount of compensation in advance.

However, certain provisions are very harsh on the builder. In the following example, taken from the general conditions of the Egyptian railways, it is interesting to note the discretion that the client reserves for himself, both as to the nature of the underlying event and its effects:

> "If it is proved to the satisfaction of the Organization, whose decision will be final, that the whole or the part of the delay arises from causes of "Force Majeure" such as strikes, shipwrecks . . . etc, the Organization may waive the right to enforce the penalty in whole or in part."

If the indemnity for late performance clause is silent on the question of imputability, the answer is probably to refer either to the solutions offered by the ordinary law applicable to the contract,[7] or to the provisions of the contract that cover exemption clauses generally.[8] The following clause seems to penalize the supplier "whatever the reason for the late performance," but it does not rule out *force majeure* in actual fact: it makes an express reference to Article 2.4 of the contract, which provides for an extension of the time limits, without compensation, in the event of *force majeure:*

> "En cas de dépassement des délais contractuels fixés dans le Marché ou prorogés dans les conditions prévues à l'article 2.4, le fournisseur est passible de pénalités, quelle que soit la cause du

[7] On that point, it is worth noting that in certain legal systems, in particular under *common law,* contractual liability is interpreted much more strictly than in others.

[8] On this point, cf. Chapter 8, on *force majeure* clauses.

retard et sans qu'il soit besoin d'aucune notification préalable, la seule échéance du terme le constituant en demeure."

2. *Differentiated Clauses.* Some contracts include a set of clauses penalizing, in various ways, a contractor's late performance in carrying out his various obligations:

"14.1. Dédommagements pour retards dans la fourniture des documentations . . .

"14.2. Pénalités pour le retard de livraison des machines, du montage et de la réception . . .

"14.3. Pénalités pour le retard de livraison des pièces de rechange . . .

"14.4. Pénalités pour le retard des délais de livraison pour la suppression de défauts . . ."

3. *Exclusions.* Sometimes the contract excludes any compensation for late performance in case of specific obligations:

"The supplies made free of charge by . . . by virtue of Article 3, par. 5, and Articles 12 and 13 shall not be subject to penalties for delay."

4. *Grace Period.* Provision may be made for a grace period:

- ". . . à l'issue d'une période de grâce initiale de soixante jours . . ."
- ". . . after a grace period of two weeks . . ."

But what is the position once the grace period has expired? Should compensation be calculated from the initial time limit, or only from the expiry of the grace period? The drafters of clauses do not always consider this alternative, and some forms of wording may lead to serious problems of interpretation. This is not the case for the following clauses, which set out their position explicitly, albeit in two different ways:

- "After the grace period, the delay taken into account for penalty calculation will start from contractual delivery date."
- "Un pour cent du prix des travaux d'infrastructure par mois de retard imputable au constructeur pour chacun des deux premiers mois de retard à l'issue d'une période de grâce initiale de soixante (60) jours."

5. *Amount of the Penalty.* The penalty usually consists of the payment of a certain sum or a percentage of the price, per period of late performance:

- "Pour non-respect des délais garantis à l'article 10, A paiera à B 10.000 par semaine entière de retard pour chaque section."
- ". . . A shall pay . . . liquidated damages at the rate of one per cent (1%) of the contractual price per week of delay . . ."

The penalty may increase if the delay persists:

". . . un pour cent du prix des travaux d'infrastructure par mois de retard imputable au constructeur pour chacun des deux premiers mois de retard;

"deux pour cent du prix susvisé par mois supplémentaire de retard imputable au constructeur."

6. *Basis of Calculation.* The basis of calculation for working out the percentage of the penalty often leads to interesting arrangements.

This basis may be strictly defined, limiting it to the part of the works that are behind schedule:

- "Au cas où la date d'achèvement des travaux ne serait pas respectée par suite d'une faute du fournisseur, le client pourra, pour autant qu'il prouve avoir subi un dommage, exiger pour chaque semaine de retard une indemnité de 0,50% avec un maximum de 5% de la valeur de la partie des travaux de montage non terminés dans les délais fixes."
- "En cas de retard dans l'exécution des travaux, qu'il s'agisse de l'ensemble du marché ou d'une tranche pour laquelle un délai d'exécution partiel ou une date limite a été fixé, il est appliqué . . . une pénalité journalière de 1/3000 du montant de l'ensemble du marché ou de la tranche considérée."

A consulting engineer will often seek to limit his liability according not to the value of the works, but to the amount of his fees:

"En cas de retard dans la mise en route de l'unité qui serait imputable à l'Ingénieur, sa responsabilité financière est fixée contractuellement à 1% du montant des honoraires tels qu'ils résultent de l'article XI, 1 et 3, par quinzaine de retard par rapport au délai prévu au premier alinéa de l'article IX."[9]

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[9] Such limitations on liability are sometimes in breach of professional rules (see Rule 15,14 of the *Rules of the Association of Consulting Engineers*, as regards works carried out in the United Kingdom), or even of mandatory legislation regarding the liability of architects and building contractors (in particular in certain Arab countries).

In a contract for the construction of a factory in Algeria, the basis for calculating the penalties used the value of the equipment as a reference point:

"L'assiette des pénalités de retard dans la réalisation des opérations de montage ou de réalisation des performances contractuelles est calculée sur base de la valeur globale des matériels et pièces de rechange Cif-Port-Algérien."

The following clause taken from another contract, concluded with Algeria, contains a novel variation:

"Au cas où, à la suite d'un retard de la part du constructeur dans la remise des spécifications et données nécessaires à la passation des commandes ou dans la préparation des appels d'offre dans le cadre des articles IV, V et VIII ci-dessus, M.O. serait contraint, afin de respecter le Planning Contractuel de Réalisation, de procéder à une importation de biens ou de services qui, en l'absence d'un tel retard, auraient pu être fournis dans les délais requis par une entreprise algérienne à des conditions aussi favorables, le constructeur paiera une pénalité égale à dix pour cent (10%) de la prestation ou de la fourniture considérée."

Some very detailed contracts provide for specific differentiated bases of calculation according to the stages in the works at which the delays occurred:

"1° Pour un retard imputable au constructeur dans l'achèvement des travaux d'infrastructure . . . un pour cent du prix des travaux d'infrastructure par mois de retard . . .

"2° Pour tout retard . . . dans l'achèvement de l'édification du complexe industriel, les pénalités de retard seront calculées de la manière prévue au paragraphe 1° ci-dessus, étant entendu que l'assiette devant servir de base de calcul de ces pénalités sera constituée par le prix des travaux d'édification . . .

"3° Pour tout retard imputable au constructeur dans le démarrage des 3 unités de production . . . les pénalités de retard seront calculées de la manière prévue au paragraphe 1° ci-dessus, étant entendu que l'assiette devant servir de base de calcul sera constituée par la valeur du matériel de production non encore livré à laquelle s'ajoutera la valeur du matériel de production inutilisable par suite du retard de livraison d'une partie dudit matériel de production.

"4° Pour tout report non imputable à . . . de la signature du procès-verbal de la réception définitive . . . , les pénalités de retard seront calculées de la manière prévue au paragraphe 1° ci-dessus, étant entendu que l'assiette devant servir de base de calcul de ces pénalités sera constituée par le prix du matériel de production . . ."

Note that, in paragraph 3° of the preceding clause, the basis of calculation may be widened when the delay in performing a specific obligation has repercussions on the effectiveness of performance of other obligations.

That is also the purport of the following clauses, taken from conditions applying to public contracts concluded respectively with Portugal, Saudi Arabia and Egypt:

- "Si la livraison d'une partie seulement de la fourniture est en retard, les pénalités sont calculées sur la valeur de cette fraction; toutefois, elles sont déterminées d'après la valeur totale de la fourniture si ce retard rend inutilisable la fraction déjà livrée."
- "The fine specified in the preceding Article shall be calculated on the final account for the entire operation if, in the opinion of the soliciting agency, the delayed part precludes full utilization of the work on the specified dates, or interferes with the use of any other utility, or has a direct adverse effect on the completed portion of the work."
- "When time limits set by the contract are outpassed, the supplier and/or the contractor shall be subject to a penalty set as being 1% (one per cent) of the contractual value of the delayed part of each complete week of the delay, or of the total value of the contract if the delay affects the project of implementing the Metro. The Organization's decision regarding the choice is final, and belongs solely to its discretionary authority."

In the latter two instances, note the discretionary nature of the assessments to be made in each case.

7. *Ceilings.* Ceilings are commonly used in international contracts[10] so that the penalty is limited to a certain maximum rate:

- "The total amount of the delay penalty will not exceed a maximum of four per cent (4%) of the price of the Contract."
- "Contractor shall pay to the Owner as liquidated damages a sum equal to $50,000 for every period of 10 days which shall elapse

[10] Compare with Article 20.5 of the *Cahier de clauses administratives générales applicables aux marchés de travaux en France* (Decree of 21 January 1976): "le montant des pénalités . . . n'est pas plafonné."

between the time mentioned above and the date of Ready for Start-Up of such Working Entity, provided however, that Contractor's liability under this Article 18.2 with respect to any Working Entity shall not exceed an amount equal to 5% of the price of such Working Entity."

If specific penalties have been laid down according to the different obligations, they may be cumulative:

"Les pénalités susvisées seront cumulatives, le cas échéant."

However, an overall maximum amount is often specified for the totality of the contractual penalties:

- "Le montant global des pénalités pour retard au montage et non conformité des performances est limité à Dix pour cent (10%) du montant global prévu dans le Contrat."
- "The total of penalties for delay will not exceed . . . % and the total of penalties for failure to reach the guaranteed performance will not exceed . . . % of the price of the equipments mentioned in Article 6. The total of all penalties shall not exceed . . . % of this price."

Whether we are looking at limiting the amount used as the basis of calculation for penalties, or imposing an individual or overall ceiling, these contractual practices highlight the function of the penalty clause in limiting liability.[11]

8. *Amnesty.* Some contracts provide for the refund or reduction of penalties incurred during the initial phases of works if all or part of the delay is made up at a later date:

- "Les pénalités de retard versées à B conformément aux paragraphes 1° et 2° ci-dessus seront remboursées au constructeur dans la mesure où le démarrage de la production tel qu'il est prévu au Planning Contractuel de Réalisation aurait lieu effectivement à la fin des trente-neuvième (39^{e}), quarante et unième (41^{e}) et quarante-troisième (43^{e}) mois à compter de la date de prise d'effet en ce qui concerne respectivement l'unité-moteurs, l'unité-lampes et l'unité- "appareils ménagers."
- "Should the Constructor obtain Main Test Run Certificate by the 51st month, the same amount of penalties referred to above shall be refunded to the Constructor."

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[11] Cf. *infra*, pp. 338–340 and 346.

- "If most of the Work is completed and can be operated continuously and should B and Contractor agree to operate the parts of the Plant which are Ready for Commissioning and if the production so achieved reaches 50% or 75% of the total production of fertilizers the penalty per week will be reduced respectively to 0.15% and 0.05% per full week."

9. *Prior Formalities.* Is any penalty for delay due automatically or should any *notice* be given beforehand? In the absence of any express provision, reference should be made to solutions afforded by the law applicable to the contract, which vary.[12] Some of the clauses examined explicitly consider the point.

Here the requirement for notice is dispensed with:

- "The liquidated damages stated in Arts. 39 & 40 shall be applicable without notice, immediately after delay."
- "En cas de dépassement des délais contractuels fixes dans le marché ou prorogés dans les conditions prévues à l'article 2.4., le Fournisseur est passible de pénalités, quelle que soit la cause du retard et sans qu'il soit besoin d'aucune notification préalable, la seule échéance du terme le constituant en demeure."

And the opposite is found:

"The penalties, when applicable, will be paid by A upon request of the buyer submitted by registered mail."[13]

10. *Proof of Loss or Damage.* One of the main advantages of the penalty clause is that it establishes, in advance, the amount of compensation payable, and it therefore dispenses the injured party from having to prove the loss or damage resulting from the other party's breach.

This is the main thrust of the following clause:

"The penalties for delay are incurred without the Organisation being obliged to summon the Contractor or give him any previous notice and without proof by the Organisation of special damage."

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[12] The rule "Dies non interpellat pro homine" (the debtor is not on notice solely as a result of effluxion of time) for example applies in French law (Article 1139 of the Civil Code) whereas it is excluded in German law (Section 286 II, 1) B.G.B.). The rule is not known in common law.

[13] Another possible interpretation of the clause is that the requirement for a registered letter relates only to the payment of the penalty and that its becoming due does not depend on the giving of prior notice.

However, the Group encountered examples of clauses where the penalty for late performance only became payable where the injured party could show loss:

- "Au cas où la date d'achèvement des travaux ne serait pas respectée par suite d'une faute du fournisseur, le client pourra, pour autant qu'il prouve avoir subi un dommage, exiger pour chaque semaine de retard une indemnité de 0,50% avec un maximum de 5% de la valeur de la partie des travaux de montage non terminés dans les délais fixés."
- "Il a été admis lors des discussions du 10/8/77 en nos usines que les pénalités ne sont applicables que si . . . doit supporter des dépenses supplémentaires consécutives à vos retards (pénalités exigées par le Client ou travaux à horaire spécial pour rattraper les retards)."

Such clauses, which favor the contracting party owing the obligation, are to be avoided by the party to whom the obligation is owed, since they deprive the penalty clause of a substantial part of its effectiveness.[14]

An intermediate situation can be illustrated by the following clause, where the burden of proof appears to be reversed, since the party owing the obligation has to prove the absence of damage to avoid application of the penalty clause:

> "The penalties for delay are not applicable if the delay has caused no prejudice to the buyer."[15]

11. *Arrangements for Payment.* The arrangements for payment of the penalty may be specified:

- "Liquidated damages shall comprise of the following and be paid in foreign currency."
- "Any liquidated damages due from the Seller to the Purchaser under this Art. 10 shall be paid in US Dollars upon delivery of the object pursuant to Sections 7.6. and 7.7. hereof."
- "The payment of these penalties will be effected by retention on the outstanding amount remaining due by . . . at the Last Ready for Commissioning Certificate and/or by transfer by the Contractor to . . ."

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[14] The problem raised by these clauses is not to be confused with the question whether payment of the penalty clause precludes the party to whom the obligation is owed from claiming additional damages (Cf. *infra*, pp. 346–349).

[15] Compare with Article 7.3 of Contract No. 188 of the United Nations' Economic Commission for Europe.

- "The Employer, without prejudice to the other collection methods, shall deduct the delay fines from sums due to Contractor."

In the last two cases, the penalty is paid by offsetting; this system will be compared below with some forms of withdrawal payments (*clauses de dédit*).[16]

A more original clause is to be found in this contract concluded with a developing country:

> "Toutefois, selon la nature et l'importance du retard d'une date de démarrage, le maître de l'ouvrage aura la faculté de demander en paiement de la pénalité prévue ci-dessus, la livraison gratuite par le constructeur des pièces qui devraient être fabriquées dans l'usine à la date de démarrage de la section de production concernée et qui ne le serait pas en raison d'un retard imputable au constructeur, étant entendu que la fourniture de ces pièces devra être effectuée (i) dans les quantités nécessaires pour assurer la production des produits dans les quantités minimales prévues à partir de chaque date de démarrage au Planning Contractuel de Réalisation et (ii) pour autant que la fabrication desdites pièces n'aura pas été assurée conformément aux normes de qualité et dans les quantités requises."

This clause, whose application is left, to a considerable degree, to the discretion of the client (*selon la nature et l'importance du retard*) is obviously liable to put the builder in an awkward position if he does not manufacture the components in question himself. As far as the client is concerned, the attraction of this clause is, among other things, that it enables him to purchase the components in question without an import license, since the supply is free of charge.

12. *Combination With Other Remedies.* Does the payment of penalties on account of delay rule out any other remedy?

(i) Obviously, the obligation to perform still exists, as the following clauses show:

- "The payment or deduction of such Liquidated Damages shall not relieve the Contractor from his obligation to fulfil the Works and/or Services. . . ."
- "Les parties conviennent que la réalisation du complexe industriel et le démarrage des unités de production doivent être exécutées avec la plus grande diligence et dans le respect des impératifs visés

[16] Cf. *infra*, pp. 336–337.

aux présentes. En conséquence, certaines pénalités de retard ont été prévues en vue d'assurer la sanction du non-respect de certains délais. Elles ne sauraient toutefois diminuer en rien les garanties stipulées aux présentes."

(ii) However, the client will often reserve the right to rely on other remedies, such as the correlative suspension of payments:

"Delays in delivery, notwithstanding other penalties they may entail, have a suspensive effect on payments. Payments are resumed only after deliveries have been restored to their normal course."

or the cancellation of the contract in whole or in part:

- "L'application des pénalités est indépendante des autres sanctions auxquelles le retard peut donner lieu, notamment la résiliation du marché."
- "The Authority shall also have the right to require the Contractor either to complete the works and continue payment of the said sum or at once or at any time thereafter by simple written notice cancel the contract or take the execution thereof out of the hands of the Contractor."
- "Si le calendrier d'exécution de la phase prototype figurant en annexe III n'est pas respecté, le titulaire encourt par jour de retard et sans mise en demeure préalable, des pénalités dont le montant est calculé par application de la formule ci-après . . . De plus, la commande annuelle du matériel de série pourra être diminuée par mois de retard d'un nombre de matériel égal au douzième de la livraison prévue. En cas de mois incomplet, cette diminution se fera pro rata temporis sur la base de . . . mois de 30 jours."

(iii) Is the obligee entitled to claim additional damages over and above the amount of the penalty clause providing for compensation for delay? This is the aim sought by the following clauses:

- "Les pénalités de retard visées aux paragraphes 1 et 2 ci-dessus sont exclusives de tous dommages et intérêts auxquels le maître de l'ouvrage pourrait prétendre en raison d'un retard imputable au constructeur, à condition que la réception définitive intervienne de manière satisfaisante dans le délai contractuel."[17]
- "Indépendamment des dispositions des Articles concernant les pénalités au cas où l'inexécution ou la mauvaise réalisation des obligations du Vendeur entraîneraient directement ou indirecte-

[17] *A contrario,* therefore, additional damages may be claimed if the delay has not been made up at the time when final acceptance takes place.

ment soit un retard de mise en production, soit un arrêt de production de l'Unité, les Parties détermineront d'un commun accord le montant du préjudice subi par l'Acheteur et à payer par . . . A défaut d'un tel accord, les parties conviennent de s'en remettre à l'arbitrage tel que défini contractuellement, mais il est toutefois convenu entre les Parties que le montant total du préjudice ne pourra dépasser dix pour cent (10%) de la valeur de la chaîne ou installation considérée."

Sometimes provision is made for additional damages only in order to make good a specific type of loss:

"Si, par suite de la négligence ou de la mauvaise organisation du Fournisseur, le programme d'exécution défini à l'article 2.3. ne peut être respecté et si le retard par référence à ce programme d'une quelconque prestation à charge du Fournisseur engendre une modification des conditions (délais, coût . . .) dans lesquelles devaient se réaliser des prestations à charge d'autres fournisseurs, la responsabilité de toutes ces modifications induites incombera au Fournisseur. Le maître de l'Ouvrage sera en droit de revendiquer le paiement de dommages et intérêts sans préjudice à l'application des pénalités prévues en cas de non-respect des délais contractuels. Cette clause sera notamment d'application dans le cas de la fourniture tardive par le Fournisseur d'informations nécessaires à l'exécution d'autres fournitures que la sienne ou en cas de retard lors du montage engendrant des perturbations du planning de montage d'autres équipements."

The following clause, which provides for the non-application of indexation to the price of the performance that is delayed, also results in imposing an additional penalty on the contracting party in breach:

"During the period of such delay, price adjustments due to indexation as per sub-clause 8.5.1. shall not apply to the price of the delayed portion."

(iv) A novel additional remedy consists in deferring the starting point for the guarantee period:

"In such case, the guarantee period shall start upon payment of such liquidated damages."

This clause is intended to encourage rapid payment of the penalty. But does it not deprive the client of any guarantee in the meantime? It would be more appropriate to provide that the guarantee period should be extended rather than merely deferring its starting point.

(v) In contrast, some contracts, which are more favorable to the constructor, preclude any other sanction:

- "The penalties for delay in deliveries and for failure to reach the guaranteed performance are limitative and their payment which compensates the Buyer for the prejudice suffered excludes all other compensation for indirect or consequential damages."
- "Au cas où la date d'achèvement des travaux ne serait pas respectée par suite d'une faute du fournisseur, le client pourra, pour autant qu'il prouve avoir subi un dommage, exiger pour chaque semaine de retard une indemnité de 0,50% avec un maximum de 5% de la valeur de la partie des travaux de montage non-terminée dans les délais fixés. Toutes autres prétentions seront exclues."
- "The liquidated damages specified in each Section of this Art. 10 are independent of each other and cumulative and shall not limit or affect any rights of the Parties pursuant to any other provisions of this Contract, provided, however, that such liquidated damages shall be strictly limited to the extent specified in each Section and the Purchaser may not on account of the deficiencies specified in Art. 10 claim other than for such liquidated damages."

Combining a penalty clause with other remedies gives rise to delicate legal problems depending on the applicable law.[18]

13. *Penalties and Incentives.* In some contracts, a penalty clause, penalizing delay in performance, takes over from a premium providing a reward for early performance. The following example shows how this combination creates a scheme to encourage the rapid execution of promised performance:

> "A bonus/liquidated damages scheme related to Time of Performance has been agreed between Company and contractor as defined in Appendix 16 entitled 'Delivery Incentive Scheme.' The Incentive Scheme is established to motivate Contractor toward an early completion of the Plant, in consideration of the importance that such early completion has for Company.
>
> . . .
>
> "Bonus is the amount by which compensation of Contractor will be increased in accordance with the method of calculation specified herein.

[18] Cf. *infra*, pp. 346–349.

"Penalty is the amount by which the compensation of Contractor will be decreased as liquidated damages in accordance with the method of calculations specified herein.

. . .

"INCENTIVE SCHEME

"The mechanical completion target date of fuel units is established as March 15, 1979.

"The mechanical completion target date of plant is established as June 15, 1979.

"The amount of bonus or Penalty attributable to Contractor shall be calculated as follows:

"If mechanical completion of fuel units occurs on or before the mechanical completion target date of fuel unit and mechanical completion of plant occurs on or before the mechanical completion target date of plant, Contractor will earn a Bonus of US Dollars $750,000.

"If either mechanical completion of fuel units occurs after the mechanical completion target date of fuel unit or mechanical completion of plant occurs after the mechanical completion target date of plant, Contractor will pay a penalty of US Dollars $750,000.

"For each calendar day that mechanical completion of fuel units comes earlier than mechanical completion target date of fuel unit, Contractor will earn a Bonus of US Dollars $6,700 up to a maximum amount of US Dollars $800,000.

"For each calendar day that mechanical completion of plant comes earlier than mechanical completion target date of plant, Contractor will earn a Bonus of US Dollars $3,350 up to a maximum amount of US Dollars $400,000."[19]

Together with the bonus for early completion, the penalty clause becomes in this case a component of a novel incentive scheme. Later on we will discuss the relationship that should be established between penalty clauses and price adjustment clauses.[20]

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[19] The clause in question has a curious, doubtless unintentional feature: on the operative date, there is an immediate switch from a bonus of $750,000 to a penalty of $750,000.

[20] Cf. *infra*, pp. 337–338.

14. *Failure to Comply With a Quicker Performance Date.* Another interesting clause examined by the Working Group penalizes very severely the delay of a builder who had obtained the order by offering rapid performance. The starting point of the penalties coincides with the time periods stipulated in the offer and the maximum amount of the fine is increased:

> "En el caso que el Contratista hubiese consignado en su oferta una reducción del plazo indicado en 12.1 la multa indicada en 12.2.1. se aplicará a partir del vencimiento del plazo ofrecido. En este supuesto el valor limite del diez por ciento (10%) para la aplicación de multas por atraso mencionado en 12.2.1. se ampliará en un diez por ciento (10%) adicional por cada mes o fracción mayor de une semana de reducción del plazo ofrecido. Este último teniendo en cuenta que la reducción del plazo previsto es un elemento que incide en el cotejo de las ofertas."

(b) Contracts for Supply. Some supply contracts provide, in the event of late delivery, for the imposition of similar penalties to those described in the above construction contracts. Thus, the clause below, relating to the sale of a ship, provides for a grace period, a progressive scale of penalties for late delivery and the option for the buyer to cancel the contract if the delay persists:

> "Delayed delivery:
>
> "(1) No adjustment shall be made and the purchase price shall remain unchanged if the Vessel is delivered within one (1) month after the Contract Delivery Date, otherwise provided for in this Contract.
>
> "(2) For each and every day of late delivery, beginning with midnight of the day one (1) calendar month after Contract Delivery Date, the purchase price of the Vessel shall be reduced by deducting therefrom per diem of delay in delivery as follows:
>
> "a) Japanese Yen 800,000 per day for second month
> "b) Japanese Yen 1,200,000 per day for third month
> "c) Japanese Yen 1,600,000 per day for fourth month
> "d) Japanese Yen 2,000,000 per day for fifth month
> "e) Japanese Yen 2,400,000 per day for sixth month.
>
> "The maximum for which adjustment shall be made shall be six (6) calendar months running from the delivery date as provided for in Article 7 hereof, otherwise set forth in this Contract.

"(3) However, if delay in delivery of the Vessel, for which the builder is responsible, continues for a period of over six (6) calendar months after Contract Delivery Date, the company may, at its option, cancel this Contract by serving upon the builder written notice of cancellation, or accept the vessel with adjustment as per Paragraph 1, sub-paragraph (2) of this article."

Progressive penalties are also provided for by this clause taken from a supply contract for electrical equipment, but they take effect immediately and they are subject to a ceiling:

"Au cas de retard dans la livraison imputable au fournisseur, il lui sera appliqué les pénalités suivantes:

"Un pour mille (1/000) de la valeur CIF/ANNABA du matériel livré en retard par jour calendaire de retard pendant les quinze (15) premiers jours.

"Trois pour mille (3/000) de la valeur CIF/ANNABA du matériel livré en retard par jour calendaire de retard à partir du 16e jour. Néanmoins, le montant de ces pénalités ne saurait en aucun cas dépasser 5% du montant global de la fourniture."

The following clause, relating to the sale of tractor-vehicles, makes the payment of fines for late delivery preclude any other remedy:

"En caso de producirse demoras en la entraga de cualquiera de los Locotractores, el Vendedor pagará al Comprador en concepto de multa una suma equivalente al medio por ciento (0.50%) del valor, antes de cualquier ajuste de precio, por cada quince (15) dias corridos o fracción mayor de siete (7) dias corridos de atraso, hasta un limite del cinco por ciento (5%) del valor antes de cualquier ajuste de precio, de cada Locotractor demorado, con la salvedad que el Vendedor no pagará multas por demoras en el despacho o otros incumplimientos justificados o excentos de responsabilidad, según el Articulo N°11. Dichas multas a cargo del Vendedor constituirán la liquidación total de cualquier obligación del Vendedor hacia el Comprador por la respectiva demora."

The following clause, taken from a contract between a Polish seller and a Swedish buyer, also stipulates exemption from other remedies. Note also the grace period, the buyer's release from the obligation to pay interest during the seller's delay and the buyer's option on the expiry of 180 days:

"If the object is delivered later than the date required . . . the Seller shall not be required to pay any liquidated damages for the first 30

days of such delay, but thereafter the Seller shall pay to Purchaser US $7,000 as liquidated damages for each whole day exceeding such 30 days free of penalty.

"Furthermore, the Purchaser shall not pay interest on Letter of Credit amounts as per Art. 5, sect. 5.2. during such periods of delay for which the Seller is responsible. The Purchaser may not claim on account of any delay compensation over and above said liquidated damages or make any claim on account of any delay.

"If the delivery of the object shall be delayed for more than 180 days beyond the date required . . . for any reason, the Purchaser shall be entitled, at his option, to:

"(a) reject the object, or,
"(b) accept the object at the contract price . . . minus the liquidated damages, payable under this section 10.1 . . . , or
"(c) accept the object at a mutually agreed price."

(c) Loan Contracts. Appropriate compensation for the loss ensuing from delay in the re-payment of a loan of money normally consists in the fact that interest continues to accrue at the market rate. The sanction for delay ceases to be purely in the nature of an indemnity where provision is made for the interest normally due to be increased, as illustrated by the following example taken from a Eurodollar loan contract:

"4.5. *Interest Rate on amounts overdue*—If the Borrower fails to pay any sum on the date on which such sum becomes due and payable the Borrower shall (without prejudice to all other rights and remedies of the Agent and the Banks in respect of such failure) pay to the Agent for the account of the Banks to which such sum is due, interest on such sum from the date of such failure up to the date of actual payment (as well as before any judgment), calculated on a day to day basis for so long as such sum remains unpaid at a rate which is the aggregate of

"4.5.1. two and one half of one per cent per annum, and

"4.5.2. either

"4.5.2.1. in the case of a principal amount which becomes repayable during an Interest Period, until the expiration of that Interest Period, the arithmetic mean (rounded upwards to the nearest whole multiple of one sixteenth of one per cent, if such mean is not already such a multiple) of the respective rates quoted by the Reference Banks for the determination of he interest rate applicable to that Interest Period; or

> "4.5.2.2. in any other case or if the Interest Period referred to in sub-paragraph 4.5.2.1. has expired, the arithmetic mean (rounded upwards to the nearest whole multiple of one sixteenth of one per cent, if such mean is not already such multiple) of the respective rates which the Reference Banks would from time to time have notified under sub-clause 4.4. if the overdue amount constituted an Advance made for successive periods (each of which shall constitute an Interest Period) of such respective duration as may be from time to time selected by the agent."

2. *Breach of Performance or Warranty of Quality*

Performance guarantees are regularly provided for in various types of contracts, in particular contracts for the construction of plants, supplies of equipment and manufacturing licenses. Breach of such guarantees is often made subject to a system of penalties that have certain analogies with the penalties imposed for delays in performance. Similar clauses may also be operative in the event of breach of a warranty of quality given by the vendors.

(a) Hypothesis—Imputability. The hypothsesis concerned is generally described by reference to the guarantee clauses themselves.

- "If the plant does not meet its Performance Guarantee (section 13 above . . .)."
- "Au cas où, après des essais de garantie répétés selon la clause numéro 11 . . . les garanties totales mentionnées dans les clauses n°12.2. et 12.3. ainsi que 12.4., ne peuvent être atteintes, . . ."

The problem of imputability does not arise where the obligation is an absolute one, as is the case, for example, with the guarantee for latent defects due from the vendor under French law (Article 1641 of the Civil Code). In contrast, a performance guarantee offered by a builder seems generally speaking—under the approach taken by French law—to come into the category of obligations to achieve a specific result, where the person under the duty to fulfill the obligation may still prove certain exonerating circumstances.

> "In the event that . . . the equipment does not meet the minimum performance levels, except for reasons due to K or to force majeure or similar events beyond the control of A . . ."

(b) Differentiated Clauses. A clause providing for sanctions for shortcomings in performance is sometimes broken down into specific provisions depending on the various components of the works or the various features of the breach:

"1.5.2.2. Liquidated damages (Performance)

"1.5.2.2.1. For non-fulfilment of the guaranteed capacity . . .
"1.5.2.2.2. For the Beneficiation Unit . . .
"1.5.2.2.3. For the Sulphuric Acid Unit . . .
"1.5.2.2.4. For the Phosphoric Acid Unit . . .
"1.5.2.2.5. For the Fertilizer Units . . .
"1.5.2.2.6. For the Fluorine Salts Units . . .
"2. Insufficient Speed . . .
"3. Excessive Fuel Consumption . . .
"4. Insufficient Deadweight Tonnage . . ."

(c) Progressive Increase—Tolerance. A scale of differences, in relation to the performances guaranteed, is often laid down whereby the penalties increase with the size of the difference. A tolerance may be provided for:

"En cas de non-obtention des qualités garanties, A paiera à B "les pénalités suivantes:

"Pour chaque 0,25% de P2 O5 en dessous de 31%, 3 millions FB.

"Pour chaque 0,25% de P2 O5 en dessous de 30%, 6 millions FB.

"Pour les premiers 5% de débit réduit: pas de pénalité.

"Pour les seconds 5% de débit réduit:?. Pour chaque 1% complet de débit réduit: 0,5% du prix du contrat.

"Pour les troisièmes 5% de débit réduit: 1%. Pour chaque 1% complet de débit réduit: 1% du prix du contrat."

The following clause provides for a less elaborate system of proportionally reducing the price:

"Si l'alternateur ne peut fournir la puissance garantie, diminuée de la seule tolérance de mesure de cette puissance, le prix global sera réduit dans le rapport de la puissance réellement développée à la puissance garantie."

In other contracts, the manufacturer enjoys a period of grace in order to attain the promised performance, before being punished either by penalty proportional to the additional duration due to its failure to fulfill his obligation or by a flat rate penalty:

- "A period of (4) months for commissioning is allowed from time of granting the Last Ready for Commissioning Certificate up to the

issuing of the Main Test Run Certificate. If the plant does not meet its Performance Guarantee (section 13 above) by the expiry of this period, the Contractor shall pay liquidated damages of 0.05% of the Contract Price for each day of the delay up to a maximum of 60 days."

- "In the event that, four months after the contractual delivery date, the equipment is not ready for acceptance or does not meet the minimum performance levels, except for reasons due to K, or to force majeure or similar events beyond the control of A, K shall receive from A an additional sum of one hundred thousand French Francs (100,000) as liquidated damages."

(d) Basis of Assessment. The basis for assessing the penalty may also vary as in the case of compensation for delay. Here is an example of a basis for assessment that varies according to the deficient element:

- "Above percentage will apply to the total Contract Price."
- "For the NPK Unit and the Fluorine Salts Units, the same principle will apply but the percentage will apply to the price of each Unit."

(e) Ceilings. Penalties for non-fulfilment of guaranteed performance are often subject to ceilings:

"Les pénalités payables par A au titre de l'article 11.1. ne pourront dépasser 6% du prix de vente."

Furthermore, a global maximum limit is often laid down for the contractual penalties as a whole.

(f) Arrangements for Payment. The methods for the payment of compensation for non-fulfilment of guarantees are rarely specified. It is true, however, that they generally consist of a reduction in the price, which obviously facilitates recovery. Moreover, there is no question of proving the damage, since this is objectively established by the fact of insufficient performance.

(g) Combination With Other Remedies. Does payment of a performance penalty preclude any other remedy?

1. The clauses of this type considered by the group rarely raised this issue, unlike the clauses relating to delay discussed above. The only clause found was the following, where the penalty is expressly stipulated to release the other party from all other obligations:

". . . the Contractor shall pay the liquidated damages according to the scale hereunder.

"After that payment, the Unit(s) shall be deemed to have completed the Test Run(s) and have met their performance guarantees."

2. The scale of penalties, however, goes down generally only to a specific degree of default, beyond which other remedies may replace the penalties:

- "Pour un débit réduit et une non-obtention des quantités selon la clause n°12, de plus de 15%, l'acheteur est autorisé à:
  "soit demander une diminution correspondante de prix
  "soit demander la résiliation du contrat complète ou partielle.
  "Dans ce cas, un entretien aura lieu entre le vendeur et l'acheteur après le procès-verbal de prise en charge pour parvenir à un règlement à l'amiable.
  "Au cas où ce règlement ne pourrait être obtenu, le tribunal d'arbitrage décidera des droits et devoirs des deux partenaires du contrat."
- "3.2. If the Equipment falls below 90 per cent efficiency the purchaser shall be entitled to return the Equipment to the supplier on the terms set out in sub-clause (4).
  "4. If the purchaser exercises his right to return the Equipment then:
  "(i) The supplier shall refund forthwith all the purchase money, including cost of transportation, all duties, levies and taxes and the cost of installation and commissioning; and
  "(ii) The supplier shall allow the purchaser the use of the Equipment free of charge for such a period (not exceeding twelve months) as the purchaser shall reasonably require to order and obtain delivery and installation of alternative equipment, and
  "(iii) The supplier shall remove the Equipment and make good the site at his own expense."

(h) Penalties and Incentives. As with penalties for delay, compensation for insufficient performance or quality may be combined in an overall incentive system in which bonuses constitute a reward for performance or quality exceeding what was promised.

Here is an example in which a groundnut seller receives an increased price if he supplies products of superior quality or a decreased price if the products supplied are inferior:

> "9. Quality: the groundnut kernels to be in good condition at the time of shipment and on arrival the basis shall be:
>
> "(a) Purity: the Buyer to receive an allowance equal to the percentage of admixture.

"(b) 47% Oil Content to be determined in the pure kernels by total extraction method using ether as the solvent. Any excess to be paid for by Buyer and any reduction to be allowed for by the Seller at the rate of 1% of the contract price of each 1% oil. All fractions in proportion.

"(c) 3% Free Fatty Acid Content (expressed as Oleic Acid, Molecular Weight 282—and as a percentage of the extracted oil. Any reduction to be paid for by the Buyer at the rate of 1% of the contract price for each FFA.

"Any excess to be allowed for by the Seller at the rate of 1% of the contract price for each 1% FFA up to and including 7% FFA and the rate of 2% of the contract price for each 1% FFA over 7% FFA up to and including 10% FFA. All fractions in proportion. If the FFA content is over 10%, the Buyer shall receive an allowance to be agreed upon between the Buyer and Seller or by arbitration as stipulated in Clauses 21 and 22."

With such a clause it is difficult to determine the demarcation line between a penalty clause and a price adjustment clause[21].

3. *Failure to Supply*

The obligation of the vendor to supply the object of the contract rarely seems to be covered by penalty clauses.[22]

However, here are two clauses of this type that were stipulated in order to cover eventualities in which failure to deliver could give rise to a particular loss or damage on the part of the purchaser.

(a) In a contract for the supply of steam, the clause provided for compensation proportionate to the duration of the failure to supply, but the vendor took care to limit his liability to the payment of that compensation:

"En cas d'inexécution d'une des clauses du présent contrat par l'Exploitant pouvant entraîner une diminution de l'énergie mise à disposition de X, ou en cas de demande de vapeur, conforme à l'article II (c'est à dire 3 heures avant) non-honorée, X sera fondé à réclamer à l'Exploitant une pénalisation égale à:F(P2A,5000) par heure complète d'insuffisance.

[21] Cf. *infra*, pp. 337–338.

[22] What is contemplated here is a case of irremediable failure to deliver; the case of a mere delay in delivery has been considered earlier.

"X pourra déduire ces pénalités des facturations que lui fera l'Exploitant au titre du présent contrat. Les pénalités prévues au présent article constituent les seuls dommages et intérêts susceptibles d'être réclamés par le Client tels que prévus au Code civil (article 1150 et suivants) par suite d'inexécution de ses obligations par le prestataire et ce, à l'exclusion de tout autre préjudice immatériel."

The loss caused to the purchaser by an interruption of supplies of steam is liable to be disproportionately large in comparison to the supplier's interest in the contract. The above clause limits his liability.

(b) The following clause illustrates the specific problem of establishing the damage ensuing from the failure of a sub-contractor. Such damage may also be considerable insofar as a default in relation even to a component or a secondary operation may compromise the whole of the operation. The following clause deals with the supply of gearboxes for cars by a sub-contractor:

- "Dans le cas où les chaînes de montage de véhicules destinés à recevoir les boîtes seraient arrêtées chez A ou chez l'un de ses sous-traitants en France, par manque de boîtes imputable contractuellement à B, B paierait à A une indemnité égale à la valeur de la boîte par véhicule qui ne pourrait pas être terminé de ce fait.
- "La quantité de véhicules à prendre en considération serait la quantité moyenne journalière de véhicules produits par A dans le mois précédent l'arrêt de chaîne. A doit informer B au moins deux semaines à l'avance de l'arrêt éventuel des chaînes de montage et B a le droit d'envoyer chez A un représentant pour constater les faits."

This example is very characteristic of the special situation in which, because one contract is inserted into another, the failure to perform the former is bound to cause substantial consequential damage.

4. *Failure to Perform an Obligation to Purchase*

(a) Under some supply contracts, the purchaser undertakes to take a minimum quantity and this obligation may be the subject of particularly severe penalty clauses. Here is a first example:

"In case Buyer's offtake during any calendar year will be lower than the quantity mentioned above minus 10%, then Buyer will pay to Seller over the difference in quantity between the thus fixed quantity and the quantity actually supplied a penalty of 50% over the

average selling price per metric ton paid in that particular calendar year."

The following clause, which relates to a contract for the supply of gas, is even more draconian since the quantities not taken are invoiced (take or pay), which is tantamount to imposing a 100-percent compensation.

> "Pour tous les débits constatés inférieurs au minimum convenu, X facturera à Z, à titre d'indemnité de mise à l'air, les quantités manquantes. Toutefois, aucune pénalité ne sera facturée si les quantités manquantes sont inférieures à 2% de la quantité d'hydrogène prévue d'être livrée dans le mois, cette quantité étant obtenue en multipliant les débits horaires convenus par le nombre d'heures convenu dans le mois.
>
> Il est entendu que cette indemnité de mise à l'air ne sera versée que dans la mesure où les quantités manquantes seront dues au fait de Z, et dans la mesure où il n'y aura eu ni force majeure, ni entente préalable."

The severity of the sanction is due to the fact that the gas not taken has to be evacuated (*mise à l'air*) and it is therefore lost to the vendor. On the other hand, such take or pay obligations in gas supply contracts are often also justified by the fact that the supplier is himself bound by long-term contracts containing strict obligations of purchasing minimal quantities.

(b) Counter-trade contracts also impose an obligation to purchase, that is to say the purchase of compensation products, to the extent of a specified percentage of the price of the main supply.[23] Typically, this obligation is coupled with a penalty clause:

> "Au cas où B ne remplirait pas ou ne remplirait qu'en partie ses engagements d'achat pour des raisons dont il aurait à justifier, B verserait à A sans autres réclamations une pénalité de . . . % de la valeur de l'engagement non-rempli.
>
> "En couverture des pénalités, B dépose à la mise en vigueur de l'accord une garantie bancaire auprès d'une banque de premier ordre. Cette garantie diminue en liaison avec le montant de la pénalité portant sur les sommes en compte."

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[23] See M. Fontaine, Aspects juridiques des contrats de compensation, *D.P.C.I.*, 1981, 7, pp. 179–223.

It will be noted that the penalty is covered by a bank guarantee, a stipulation habitually found in offset contracts.[24]

5. Failure of a Licensor to Discharge His Obligations With Regard to the Defense of Patents

In a patent licensing agreement, the licensor undertakes to defend the patents against use by third parties. The sanction attached to this obligation consists in the provisional suspension of royalty payments:

> "A shall take prompt enforcement action, against third party infringers whose infringement activity coincides with B's efforts to sell Products manufactured under this Agreement. Failure on A's part to take appropriate steps to enforce its rights under the patents in Appendix A within 90 days of notice by B of third party infringement activity noted above shall exempt B from payment of any further running royalty on Products that B continues to sell in the considered country."

This suspension is not to be equated with the defense of withholding performance, as its effects are definitive: royalties unpaid during the licensor's period of inactivity will never ever be payable. But is this a penalty clause? The sanction does not require the obligor to pay a sum of money, but he incurs the loss of a sum that would otherwise be payable to him.[25]

6. Failure to Comply With an Obligation to Refrain From Acting

(a) Certain obligations to refrain from acting, which are imposed upon the licensee under a manufacturing licensing contract, stipulate penalties by the following clause:

> "Sous réserve d'autres dommages que A aurait le droit de réclamer à B pour préjudices qui pourraient lui être causés, B s'engage à payer à A une pénalité de francs suisses 200 (deux cent francs suisses) par cheval effectif en cas de violation des articles II (interdiction prévue au deuxième alinéa), et article X du présent contrat et pour chaque moteur fabriqué, fourni ou vendu, directement ou indirectement, contrairement aux stipulations du présent contrat.

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[24] *Id.* pp. 198–200.

This manner of proceeding is also mentioned in the proceedings of UNCITRAL: see Doc. A/CN9/WG.2/WP.33, February 12, 1981, No. 17.

[25] Cf. *infra*, pp. 340–341.

"En outre, A pourra, dans ce cas de violation de la part de B, résilier immédiatement de plein droit le présent contrat sans aucune indemnité ni dédommagement quelconque."

Consequently, the clause does not preclude combining the penalty with additional damages; termination of the contract is also possible.

A similar provision may be found in a standard form contract relating to the sale of the right to use a tailor-made software product.

"Au cas où le client proposerait ou vendrait un programme, ou proposerait à la vente des services sur un programme ayant des performances comparables au progiciel qui fait l'objet du présent accord, . . . aurait le droit de faire examiner ce programme par un expert indépendant.

"Si cet expert constate que le programme cédé est identique en tout ou partie au progiciel objet du présent accord, ou en est manifestement une dérivation directe, le client devra verser à . . . 150% (cent cinquante pour cent) du prix reçu pour la fourniture du programme ou du service, mais au minimum 500,000 FF (cinq cent mille francs français) pour chaque proposition ou cession du progiciel, à moins que le client ne puisse apporter la preuve par écrit qu'il a acquis d'un tiers, notoirement possesseur d'un logiciel comparable, le droit d'utiliser et/ou de céder ledit programme."

The severity of this clause is designed to make up for the weaknesses in the legal protection of intellectual property in the information technology sector. Vendors seek to protect themselves by contractual means and the deterrent effects of very heavy penalties. A further notable feature of this penalty clause is that it stipulates a minimum amount.

(b) The German Defense Ministry endeavors to suppress the granting of advantages to its representatives responsible for concluding public contracts. Since the applicable criminal provisions are liable to be without effect *vis-à-vis* foreign companies, contractual sanctions are arranged by ministerial circulars and inserted into contracts. Here is an example:

"Der Auftragnehmer oder seine Beauftragten dürfen Personen, die beim Auftraggeber mit Aufgaben auf dem Gebiet der Forschung, Entwicklung oder Beschaffung betreut sind, weder unmittelbar noch mittelbar Vorteile anbieten, versprechen oder gewähren. Dies gilt auch, wenn ein Vertrag über ein Vorhaben der vorbezeichneten Art nicht zustande kommt.

"Für jeden Fall der Zuwiderhandlung hat der Auftragnehmer dem Auftraggeber eine Vertragsstrafe in Höhe von 10% des im Angebot

genannten Preises zu zahlen. Gibt der Auftragnehmer innerhalb von 10 Jahren weitere Angebote ab, so sind bei der Berechnung der Vertragsstrafe auch die Preise dieser weiteren Angeboten mit einzurechnen. 12 VOL/B findet keine Anwendung. Der Auftraggeber kann bei Vorlegen besonderer Umstände die Vertragsstrafe nach Massgabe bestehender Vorschriften herabsetzen."

It will be noted that the conduct to which the penalty applies is generally pre-contractual, and that the penalty applies even if the contract is not concluded (it is however binding if the party contravening the clause is bound by the conditions of the call for tenders to which it responded); this falls outside the normal run of penalty clauses. The seriousness of the penalty will also be noted, since it is applicable to all tenders made over the next ten years; consequently, a whole pattern of trading is affected.

B. General Considerations Concerning Practice

The analysis carried out by the Working Group is based principally on the sample collected by its members. This analysis has enabled a number of conclusions to be inferred with regard to practice in the matter of penalty clauses in international contracts. In what types of contracts do they appear in particular? To what types of obligation do they relate? What techniques are used to develop these clauses? But is the sample sufficiently representative as to allow the conclusions to reflect fully and faithfully what happens in practice?

It would be presumptuous to draw this conclusion. Penalty clauses are too diversified in their applications for the group to make any claim that it could have covered all their aspects having regard to the group's random composition and the manner in which its contributions were selected.

However, there has been other research into penalty clauses. The U.N. Commission on International Trade Law has taken an interest in penalty clauses, as we have already mentioned; uniform rules have been adopted. At the beginning of its work, UNCITRAL also gathered useful information about practice in this area.[26] Yet even though UNCITRAL obviously has better means of investigation at its disposal, no more does its sample appear to fully reflect the phenomenon as a whole as far as the Working Group has been able to tell. The brief reflections set out below compare the findings of these two research efforts with a view to to pinpoint what has been established and what might be subject to further investigation.

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[26] See Liquidated Damages and Penalty Clauses, Report of the Secretary General, Doc. A/CN.9/161, April 25, 1979 (hereinafter referred to as "the First UNCITRAL Report") and Liquidated Damages and Penalty Clauses (II), Report of the Secretary General, Doc. A/CN.9/WG2/WP.33, 12 February 1981 (hereinafter referred to as "the Second UNCITRAL Report").

1. *Types of Contracts*

As for the types of contracts in which penalty clauses were found, there is a marked difference between the Working Group's sample and the first sample used by UNCITRAL. The Working Group, doubtless owing to its particular make-up, principally concentrated on clauses taken from building contracts. In contrast, UNCITRAL's first sample was made up of 71 sales contracts, as against only five contracts "for the supply of equipment and service" and three other contracts.[27] UNCITRAL's secretariat realized that its sample was skewed in this way[28] and seems to have corrected it subsequently.[29]

In any event, comparison of the two investigations shows that penalty clauses are frequently met, both in sales contracts and in construction contracts. But to judge by some of the examples cited,[30] they also appear to be present in other contracts (loan, transport, distribution, licensing, etc.), and it would be worth the effort of a more detailed analysis.

Furthermore, the first UNCITRAL sample apparently includes a substantial proportion of clauses taken from general conditions, whereas the Group worked almost exclusively on clauses incorporated in negotiated contracts. It seems that this difference was also attenuated by UNCITRAL's second sample.[31] Without denying the quite special interest of clauses taken from general conditions (especially from UNCITRAL's perspective of drawing up a uniform law), negotiated clauses would be a better choice to reveal the wide variety of penalty clauses encountered in practice.

2. *Types of Obligations*

In our view,[32] what is more enlightening is the analysis based on the types of obligations which may suitably be the subject of penalty clauses. We have set out here the very interesting table drawn up by UNCITRAL's secretariat on the basis of its first sample:

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[27] First UNCITRAL Report, p. 11, No. 32 (pagination is given for the English version of the two reports).

[28] *Id.*, p. 13, note (11).

[29] Second UNCITRAL Report, p. 5, note (7). However, no more figures are given against the list.

[30] Cf. *supra*, pp. 318–319 and 326–328.

[31] Second UNCITRAL Report, p. 5, No. 8.

[32] Cf. *supra* pp. 301–302.

"Kinds of breach for which liquidated damages or penalties were payable, the number of liquidated damages or penalties clauses for each type of breach:

Delay in delivery goods by seller:	*24*
Delay in payment by buyer:	*24*
Delay in shipment by seller:	*11*
Diminution of price consequent upon quality defects in goods:	*10*
Delay by buyer in taking delivery:	*5*
Failure to meet guaranteed standards:	*4*
Non-delivery of goods:	*4*
Violation by buyer of prohibition of export out of the country of destination:	*3*
Default in general:	*3*
Delay in delivery of technical documentation:	*2*
Non-payment of the price:	*2*
Payment by borrower in advance of the stipulated date of repayment:	*1*
Default in tender of documents:	*1*
Default in shipment by seller:	*1*
Delay by buyer in taking up documents presented by seller:	*1*
Payment by buyer not in accordance with instructions:	*1"*[33]

This list confirms one of the Working Group's findings, namely the particular frequency of penalty clauses for delay in performance. UNCITRAL observed this in connection with sales (obligations of the vendor)[34] as the Group mainly found with regard to construction contracts (obligations of the builder). In contrast, whereas UNCITRAL found numerous clauses containing a penalty for delay in the payment of the price by the purchaser, surprisingly, the Group did not find any clauses covering delay in the payment of the price by the client. Conversely, the Group found numerous penalty clauses relating to performance guarantees,[35] while UNCITRAL concluded that such clauses were infrequent.[36] Complementary investigations of these two practical aspects would be useful.

The relative rarity of clauses imposing penalties for failure by the vendor to deliver as found by the group[37] is borne out by UNCITRAL's list.

In view of its interest, we will include a passage from the Second UNCITRAL Report, which sets out to establish a link between the stipulation of a penalty clause and the characteristics of the obligation to which it relates:

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[33] First UNCITRAL Report, pp. 11–12, No. 32.

[34] *Id.*, p. 11, No. 32.

[35] Cf. *infra*, pp. 319–323.

[36] Second UNCITRAL Report, p. 14, No. 33.

[37] Cf. *supra*, pp. 323–324.

"An analysis of these clauses indicated that their use was associated, not with the contract being of a certain type, but with the probable presence of some of the following features:

"(i) Breach of the main obligation was relatively easy to prove (e.g. Failure to deliver on time, failure to meet a technical specification);

"(ii) The existence of some basis at the time of conclusion of the contract for estimating the loss likely to be caused from a breach. In regard to some types of contracts, norms appeared to have developed in the trade defining the limits of the agreed sums which parties might stipulate;[38]

"(iii) Proof of actual loss might be costly or difficult;

"(iv) Breach of the main obligation is not of so serious a character as to justify, at least initially, the ending of the relationship between the parties;

"(v) A need to limit the liability exposure of the party liable for breach of the main obligation;

"(vi) Circumstances which make it important to a party that he receive performance and not damages for breach."[39]

3. Absence of Penalty Clause

The absence of a penalty clause in certain contracts or with regard to some obligations may provide *a contrario* proof of the foregoing analysis. UNCITRAL has published a number of statistics,[40] which tended to show, on the basis of the first sample, that penalty clauses were absent from more than half the contracts. There did not seem to be any correlation between trade in a given product and recourse to such clauses. UNCITRAL further raised the question whether the applicable law might not play some role, since the draftsman of a contract subject to common law, for example, perhaps fear that any penalty clause would be null and void.[41]

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[38] "Thus, in relation to international construction contracts it has been stated: 'the rate of deduction for late performance varies with the size, complexity and importance of the project. As a general guide, the rate is frequently between 0.0001–0.001 per cent of the contract price per day. An upper limit is not generally specified, but if one is desired 5–10% would be reasonable.' *Guidelines for Contracting for Industrial Profits in Developing Countries* (UNIDO publication ID149 and Corr. 1), page 22."

[39] Second UNCITRAL Report, pp. 24–25, No. 52.

[40] First UNCITRAL Report, p. 11, No. 31, and p. 13, No. 33.

[41] *Id.*, p. 14, No. 35. Conversely, contracts subject to the law of a country with a planned economy frequently contained penalty clauses due to the particular importance of the performance of contracts with a view to the achievement of the Plan.

In its second study, UNCITRAL's secretariat related the possible absence of a penalty clause to the aforementioned criteria that, actually, favor the insertion of such a clause. Ease or difficulty in proving breach of the relevant obligation would appear to play an important role. Thus, a penalty clause seems inappropriate with regard to the obligations of a researcher under a research contract; such obligations can only be defined in a flexible and evolutive way and their breach cannot be determined in the same objective way as a delay in delivery.[42]

The Working Group took note of these considerations and largely agree with them. Similar observations may be made with regard to certain aspects of industrial cooperation contracts. To use French legal terminology (now also found in the Unidroit Principles, Articles 5.4 and 5.5), it might be said that penalty clauses are more appropriate with respect to "obligations to achieve a specific result" than concerning "obligations of best efforts."[43]

The absence of a penalty clause may have two more specific reasons. Sometimes the psychology of negotiation acts as a disincentive to proposing the insertion of such a clause for fear of damaging the good climate by raising the possibility, already at this stage that the contract performance might be less than perfect. Sometimes too, despite the differences between a penalty clause and withdrawal payments (*clauses de dédit*),[44] there is unwillingness to inform the other contracting party of the price it would have to pay in order to purchase its freedom.[45]

4. Drafting Technique

The UNCITRAL secretariat also made a number of interesting observations about drafting techniques used in penalty clauses, resulting in particular in the following table:

"Methods adopted to determine the amount of the liquidated damages or penalty and their frequency:

"By reference to a percentage of the price of the goods and to another factor, e.g. amount of delay or extent of deviation from agreed standards: 29

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[42] Second UNCITRAL Report, p. 25, No. 53.

[43] On this distinction, cf. *supra*, Chapter 4, pp. 218–222.

[44] Cf. *supra*, pp. 236–237.

[45] See the observation to this effect in M. Fontaine, *Aspects juridiques des contrats de compensation, D.P.C.I.*, 1981, 198.

"By reference to a percentage of the payment due and to another factor, e.g. amount of delay in payment: 18

"By reference to a percentage of the value of goods delayed in delivery and to the extent of delay: 15

"Amount of penalty undetermined in contract form, and to be fixed by parties: 9

"By reference to the rate of interest usual for delayed payment in a particular country and the extent of delay: 8

"By reference to the weight or quantity of goods and to the extent of delay: 4

"By reference to a percentage of the cost of defective goods and the extent of deviation from agreed standards: 4

"By reference to a percentage of the difference between the market price and the contract price: 2

"By reference to a sum which, if not paid, would enable the defaulter to make a profit out of the default: 1."[46]

The First UNCITRAL Report also emphasizes the adverse effect, as to the effectiveness of the penalty, of the occasional stipulation that makes payment of the penalty dependent upon proof of actual loss or damages.[47]

The Second UNCITRAL Report provides a certain amount of additional information about the manner of payment of the penalty (direct payment, relinquishment of a sum due, recourse to a bank guarantee)[48] and about the contractual treatment of the problem of the imputability of the breach to which the sanction relates.[49]

These findings of UNCITRAL are largely borne out by the research whose results are set forth in the first part of this chapter. However, our analysis brought to light other frequent or, at the very least, characteristic features of techniques for drafting penalty clauses in international con-

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[46] First UNCITRAL Report, pp. 12–13, No. 32; see also p. 14, No. 38.

[47] *Id.*, p. 14, No. 39. Cf. above pp. 309–310.

[48] Second UNCITRAL report, pp. 8–9, Nos. 17–18.

[49] *Id.*, pp. 10–12, Nos. 21–27. The Second UNCITRAL Report also considers the problems of combining a penalty, on the one hand, with performance or additional damages, on the other. (Cf. *infra*, pp. 346–349).

tracts. Reference is made, in particular, to the details and illustrations provided with regard to granting grace periods or tolerance margins, the fixing of maximum amounts and overall maximum amounts, the widening of the basis of assessment in the event of indirect damage, the possible remission or reduction of penalties, the combination of penalties and bonuses in an incentive system, etc. No doubt, these features were not worth raising in the context of UNCITRAL's work, directed as it was towards the preparation of a uniform law. But they are worthy, it seems to us, of the attention of practitioners called upon to negotiate the drafting of sophisticated penalty clauses.

The *I.C.C. Guide on Penalty and Liquidated Damages Clauses* also has drafting advice that coincides with the analyses and recommendations of this chapter. The following ICC recommendations deserve special mention:

> *"Any clause should clearly indicate whether it intends only to assess actual damages for breach or whether it intends to encourage performance by providing a private penalty as a deterrent against breach where the penalty provides for additional payments to be made on top of damages;*
>
> *"Any clause should clearly indicate whether it is exclusive or optional (i.e., whether or not it may be combined with other remedies, particularly with termination for breach and payment of damages);*
>
> *"Any clause should clearly indicate whether its lump-sum character implies that its drafters were envisaging that the lump-sum was a provisional or a final assessment of future damages."*[50]

III. LEGAL ANALYSIS

Some aspects of the drafting of penalty clauses may safely be left to freedom of contract, irrespective of the applicable law; the stipulation of a grace period is an example. An informed negotiator may merely choose from among the technical methods available, while obviously looking carefully at the quality of the drafting.

But other questions are more delicate because they call into question principles of the law relating to liability, and there the applicable law may lay down binding rules. The relationship between the compensation stipulated and the actual loss or damage is rarely a matter of indifference; a discrepancy may result in the penalty being reduced or declared invalid. Generally speaking, national law has something to say about the possible combination of a penalty and specific performance or additional damages. These problems

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[50] *I.C.C. Guide on Penalty and Liquidated Damages Clauses*, pp. 18 and 25–26.

must be mentioned. In the first place, however, their field of application needs to be defined; that is what the expression "penalty clause" mean.[51] There is a series of similar situations, marginal or doubtful, and it is important to lay down some guidelines: the rules applicable to penalty clauses, in principle,[52] do not apply to stipulations of a different kind.[53]

A. Penalty Clauses and Similar Clauses[54]

1. *Penalty Clauses and Clauses "for Winding Up the Contract"*

Clause 9 of a hire purchase contract grants the hirer the power to terminate the arrangement before the agreed term; clause 10 allows the owner to bring the contract to a premature end in the event that the hirer is in breach of his obligations or goes bankrupt.

Clause 11 provides as follows:

> "Upon termination of this agreement pursuant to clause 9 or 10 hereof . . . the hirer . . . shall pay to the owner the hire purchase price of the goods less the aggregate of
>
> "(1) the sums previously paid under the agreement;
>
> "(2) the sums due under the agreement (including any sums recoverable from the hirer under 5 hereof) up to the date of termination;
>
> "(3) the net proceeds of sale of the goods if repossessed and sold or if not, their value as determined by a dealer appointed by the owner and
>
> "(4) a discount for the acceleration of payment computed according to the direct ratio or 'rule of 78' method.
>
> "For the purposes of this clause 'the net proceeds of sale' shall mean the proceeds of sale after deducting the cost and expenses of repossession storage insurance and sale.

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[51] At the beginning of this review, a penalty clause was defined as "a clause stipulating payment of a sum of money in the event of non-performance of a contractual obligation" (Cf. *supra*, p. 300).

[52] Comp. A. Pinto-Monteiro, *op. cit.*, p. 746, who claims that liquidated damages clauses may also be modified on grounds of equity.

[53] Other problems could be examined, such as the fate of penalty clauses when the contract is terminated (cf. Liège, Jan. 15, 2001, *Journ. Trib.*, 2001, p. 311). This is related to penalty clauses possibly belonging to obligations "surviving termination" (cf. *infra*, Chapter 13).

[54] Cf. D. Mazeaud, *La notion de clause pénale*, Paris, L.G.D.J., 1992.

> "If the net proceeds of sale of the goods repossessed and the amount paid by the hirer pursuant to this agreement exceed in the aggregate the amount of the hire purchase price (with interest on overdue instalments and other sums payable by the hirer under clause 5 hereof) the excess shall be repaid to the hirer."

Such a clause is not a penalty clause. In the first place, it does not necessarily lay down a sanction for a contractual breach: the clause applies, in particular, when the hirer terminates the agreement or when the agreement is terminated as a result of the hirer's bankruptcy. Secondly, the clause does stipulate down compensation in the form of a lump sum, but simply sets out the basis on which the re-payment will be calculated.

2. *Penalty Clauses and Withdrawal Payments* (Clauses de Dédit)

In some contracts, one party reserves the right to release itself from its commitments in return for a sum of money. Accordingly, that party has a genuine option. The other party to the contract cannot call this into question, for example, by purporting to enforce the undertaking in question. Such withdrawal payments (*indemnités de dédit*) are not remedies for contractual breaches; they reflect the exercise of an agreed choice.[55]

Such an indemnity is clearly distinct from a penalty clause, at least in theory. In practice, it may be difficult to draw the distinction. Some authorities have rightly pointed out that the aims pursued by such clauses are very similar to those of penalty clauses.[56]

The following example of a withdrawal payment is taken from the Second UNCITRAL Report:

> "It is further agreed that this arrangement and all rights and obligations hereunder may be terminated by (Seller) at any time for any reason which it, in its sole discretion, deems desirable, provided, however, that, except in the case of default in performance by Distributor, Seller gives at least 30 days notice of its intention to do so to Distributor. Commission earned during the notice period, if and when notice is required, shall be liquidated damages resulting from said termination."[57]

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[55] Comp. D. Françon, *op. cit.*, p. 481.

[56] D. Françon, *id.*; First UNCITRAL Report, p. 5, No. 9.

Mention may also be made of the doctrine of "efficient breach," under which a contract obliges a party *either* to effect performance *or* to pay damages if performance proves less profitable. See, for instance, Ch. J. Goetz & R.E. Scott, Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach, 77 *Col. Law Rev.*, 1977, pp. 554–577; B. Rudden, La théorie de la violation efficace, *Rev. Int. Dr. Comp.*, 1986, pp. 1015–1041.

[57] Second UNCITRAL Report, p. 10 No. 19.

Despite the use of the expression "liquidated damages," the commission payable does not constitute a penalty for breach, but the price paid for exercising the option of termination.

Another clause, (also called *dédit*, the terminology varies), more closely resembles a penalty clause insofar as it lays down a sanction for a genuine breach of contract. Under such a clause, sums already paid by the debtor, by way of account or security, are retained by the creditor in the event of non-performance.[58] The analogy with penalty clauses is clear if the relinquishment of the sums in question constitutes flat rate compensation and not an indemnity to be taken into account when assessing damages the amount of which remains to be established. In the case of a lump-sum payment, it is worth mentioning the peculiar feature that the payment of the "penalty" precedes the breach for which it is intended to be a sanction.[59]

This situation in which the party in breach relinquishes a sum, which it has already paid, should not be confused with the one in which payment under the penalty clause is carried out by offsetting sums owed by the creditor.[60]

3. *Penalty Clauses and Price Adjustment Clauses*

Clauses providing for a penalty for a delay in carrying out an obligation or for inadequate performance as compared with the guarantees given, often provide for a scale of penalties, calculated as progressive percentages of the amount of the price.[61]

But are penalties invariably involved? Is it not conceivable to have a system under which the price varies in accordance with the delivery time and the quality of performance obtained? This analysis can also cover situations in which the contract provides not only for "penalties" but also for "bonuses" in the event of early performance.[62]

It is quite difficult to establish a distinguishing criterion. In theory, in the one case the clause penalizes a breach of contract, whereas, in the other, the supplier has a genuine option to deliver a variable quality at his discretion (obviously within certain limits) and this is reflected in the price.

In international contracts, the parties' intention is undoubtedly betrayed by the fact that, in general, such clauses expressly refer to the con-

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[58] P. Ellington, *op. cit.*, pp. 507–514; First UNCITRAL Report, p. 5, No. 11.

[59] Such clauses will be examined further below at pp. 340–341.

[60] Cf. *supra* pp. 310–311.

[61] Cf. *supra* pp. 304–305 and 319–321.

[62] Cf. *supra* pp. 314–315 and 322–323.

cept of "indemnity" or "penalty." If this were to be combined with other sanctions, this interpretation would be reinforced.[63] Additional evidence might also be found in the possible deterrent nature of the increases.

4. *Penalty Clauses and Judicial Penalties* (Astreintes)

The distinction between penalty clauses and judicial penalties (*astreintes*) has brought about a split between some members of the Working Group. The question arises where the penalty clause provides for the payment of progressive indemnities for delay.

As far as some of the French and the Belgian members are concerned, there is no question of confusing such a clause with an *astreinte.* Admittedly, an *astreinte* also constitutes a progressive penalty for delay. But it is a penalty imposed by the court as a sanction for delay in carrying out the judgment, and it is necessarily in the nature of a deterrent. *Astreintes* do not constitute agreed upon sanctions.[64]

However, other French members of the group consider that when the contractual stipulation of progressive compensation for delay is in the nature of a threat, this constitutes "contractual *astreinte*" and not a penalty clause.[65] The point of this analysis is that if the clause is interpreted in this manner, it would fall outside the courts' power of revision as provided for in Article 1152, paragraph 2, of the French Civil Code.

Without doubt, the origin of this controversy is to be found in the use of the term "*astreinte*" in some contracts drawn up in French. But the denomination used by the parties in not decisive in law. It would certainly not be sufficient to name a penalty clause an "*astreinte,*" in order to escape the application of binding legal rules.

5. *Penalty Clauses and Clauses Limiting Liability*

The discussions, about which penalty clauses have given rise, in recent years in the various countries have brought to light two of the main functions of such clauses: the indemnifying function and the deterrent function. Sometimes it is a question of providing in advance for a flat-rate sum that will adequately make good the damage resulting from any failure to perform; sometimes the clause threatens the debtor with a veritable penalty, unrelated to the damage, that can provide it with an incentive to

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[63] The characteristics of the clause quoted at *supra*, pp. 314–315 above (referred to in note 19) also suggest that it is, in fact, a penalty.

[64] For a more detailed comparison, see I. Moreau-Margrève, L'astreinte, *Ann. Fac. Dr. Liège*, 1982, pp. 47–51.

[65] See in particular D. Françon, *op. cit.*, p. 481.

perform or punish it in the event of a default. Notoriously, in some countries, this alternative will make the clause subject to reduction, if not a declaration of nullity.[66]

Examination of practice brings to light a third—very frequent—function of penalty clauses. When they are inspired by the obligor himself, they are a means for him to limit his liability. Examples have been provided in which the compensation was limited to a given ceiling (often capped by a global ceiling) and clauses where the limitation related to the basis for assessing the penalty (cf. the liability of the consulting engineer, which was limited, not to a percentage of the value of the works, but to the amount of its fees).[67] UNCITRAL has already stressed the frequent role played by penalty clauses in this area.[68]

Sometimes this function is very explicit. In a contract considered by the group, it was set out in a specific paragraph of the "Contractor's Limit of Liability" clause, which was separate from the "Liquidated Damages" clause itself. The paragraph in question was worded as follows:

> "Contractor's only liability with respect to time of performance shall be the payment of the liquidated damages specified in Article 11, limited to the maximum amount of U.S. Dollars 750,000 (seven hundred and fifty thousand)."

How, in these circumstances, can a penalty clause be distinguished from a clause limiting liability?[69]

In principle, the difference is that the penalty clause establishes a flat-rate amount, whereas a clause limiting liability fixes a ceiling below which the amount of compensation generally still has to be determined.[70] Here is an example of such a clause:

> "Au cas où, pour des motifs imputables au fournisseur, l'exécution des prestations contractuelles deviendrait impossible, dans sa totalité ou partiellement, le client serait autorisé à se désister du contrat ou à demander des dommages-intérêts. Le taux des dommages-intérêts sera limité à 10% du prix convenu pour les prestations non-exécutées par suite de l'impossibilité survenue dans ces conditions."

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[66] This question will be taken up at *infra*, pp. 342–346.

[67] Cf. *supra*, p. 365.

[68] Second UNCITRAL Report, p. 9, No. 19.

[69] On such clauses, cf. *infra*, Chapter 7, and especially p. 355.

[70] See to this effect, the First UNCITRAL Report, pp. 5–6, No. 12.

But certain shades of difference have to be taken into account. The penalty clause may lay down the basis for calculating a lump sum, which may vary according to the circumstances (for example, an amount per day of delay) and, if so, may be coupled with a ceiling. Nevertheless, such a stipulation continues to be in the nature of a penalty clause, since the determination of the compensation is still based on a pre-determined, flat-rate foundation. On the other hand, if the clause limiting liability is generally limited to laying down a ceiling, there is nothing to prevent the two techniques from being combined and a limited indemnity being determined on a flat-rate basis. In this case, there will be both a penalty clause and a clause limiting liability; this is true of the first example referred to.

Consequently, numerous penalty clauses can be clearly distinguished from clauses limiting liability and *vice versa*, but there are stipulations that have a dual nature. They may be identified on account of their having, at the same time, a flat-rate and a restrictive nature.

When a penalty clause also limits liability, its validity must be assessed in a specific manner. We shall be returning to this subject.[71]

6. *Penalty Clauses and Penalties Not Consisting of an Obligation to Pay a Sum of Money*

A penalty clause stipulates, in principle, payment of a sum of money by the party in default. At least, this was the definition that we adopted on a provisional basis at the beginning of this study.[72] But is it essential that it should have this characteristic in order to continue to be a penalty clause?

Two other types of sanctions appeared in the Group's sample. In one case, failure on the part of a licensor to pursue counterfeiters resulted in the suspension of the payment of royalties.[73] The other case was one in which a manufacturer causing the delay had to deliver components in kind that the factory should have manufactured.[74] Mention should also be made of the situation with regard to liquidated damages clauses in which the sanction consisted in the debtor relinquishing sums which he had paid in advance.[75]

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[71] Cf. *infra*, p. 346.

[72] Cf. *supra*, p. 300.

[73] Cf. *supra*, p. 326.

[74] Cf. *supra*, p. 311.

[75] Cf. *supra*, pp. 336–337.

Following UNCITRAL (First Report, p. 5, No. 10), the group also considered "accelerated payment" clauses, under which the debtor is obliged to repay the balance at an

Can this range of sanctions still be described as penalty clauses, possibly subject to binding legal rules?

The solutions adopted nationally differ. The Swiss Code of Obligations does not specify the nature of the penalty, but rules that "provisions relating to the penalty clause shall be applicable to an agreement by which part payments made are to be acquired by the creditor in the event of termination" (Article 162). Other legislation is broader. Under German law, a penalty consists in principle of the payment of a sum of money (BGB, Section 339), but the rules apply, *mutatis mutandis*, when "another performance" was promised (Section 342).[76] Under the French Civil Code, "a penalty clause is a clause whereby a party . . . undertakes to do something in the event of non-performance" (Article 1226). Belgian law has modified this provision, which now refers to payment of a flat-rate indemnity. The Italian Civil Code refers to the debtor's undertaking to carry out "a certain performance" (Article 1382). It would appear that a penalty does not necessarily consist of a sum of money in either English[77] or Spanish[78] law.

The applicable law is therefore not a matter of indifference. It may affect penalty clauses, not only clauses providing for the payment of a sum of money, but also, depending on the case, clauses providing for the relinquishment of sums of money or even for any other performance. Draftsmen of such clauses will be conscious of this when the law of the contract submits penalty clauses to binding rules.

International initiatives designed to regulate penalty clauses have resulted in different positions being adopted. The recommendation of the Council of Europe covers only the payment of a sum of money (Article 1). The broader Benelux Convention refers to "payment of a sum of money or any other performance" (Article 1). UNCITRAL restricts the scope of its uniform rules to stipulations providing for the payment or the relinquishment of a sum of money (Article 1). Consequently one form of liquidated damages, but not non-pecuniary performance, is covered.[79] The Unidroit Principles only refer to payment of a "specified" sum (Article 7.4.13), as do the Principles of European Contract Law (Article 9:509).

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earlier date in the event of default. In themselves, the sums reimbursed are certainly not penalties, since they constitute the very object of the obligation. But the sanction lies in the disadvantage for the debtor of losing the benefit of the term; this disadvantage may not be equated with a penalty clause since it is not of a flat-rate nature.

[76] Cf. M. Strauch, *op. cit.*, p. 499.

[77] P. Ellington, *op. cit.*, p. 507.

[78] B. Cremades, *op. cit.*, p. 463.

[79] Second UNCITRAL Report, p. 7, No. 13.

B. Whether the Clause May Be Declared Null and Void or Revised

(a) The most critical legal problem with which the draftsman of a penalty clause in an international contract has to grapple is the question whether a clause providing for an excessively severe sanction may be annulled or at least cut back.

1. Most national legal systems empower the courts to review excessive penalty clauses to a greater or lesser degree. In some cases, clauses not designed to be purely in the nature of an indemnity are annulled (England, Scotland,[80] Ireland,[81] United States); in others, the courts are entitled to mitigate a penalty deemed disproportionate to the extent of the loss or damage (Germany, France, Belgium,[82] Luxembourg,[83] Switzerland, Italy, the Netherlands, Portugal, Algeria, etc.).[84] For more detail, the reader is referred to the monographs on national law drawn up by members of the Working Group as cited above.[85] In principle, such provisions are binding and likely to affect

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[80] H. Schelhaas, *op. cit.*, pp. 1397–1399.

[81] K. Hoy, Penalties and liquidated damages clauses in England and Ireland, in *Structuring international contracts*, D. Campbell (ed.), The Hague, Kluwer Law International, 1996, pp. 243–251.

[82] Articles 1226 and 1231 of the Belgian Civil Code, as modified by the Law of November 23, 1998. This reform prohibits penalty clauses of a deterrent nature and empowers the judge to reduce amounts that are excessive in relation to the foreseeable damage. With this modification, Belgium occupies an intermediate position between common law countries (nullity of deterrent clauses, validity of clauses of liquidated damages) and most civil law countries.(validity of clauses of both kinds, judicial review of excessive amounts); cf. H. Schelhaas, *op. cit.*, pp. 1412–1413.

[83] Law of March 15, 1987 cited by D. Philippe, Autonomie et contrôle des clauses contractuelles dans les relations entre professionnels, in *Le droit des affaires en évolution, L'entreprise et son client:un partenariat constructif*, Association belge des Juristes d'Entreprise, Brussels, Bruylant, 1997, p. 213.

[84] Note also that, under French law, the courts may increase a penalty deemed to be derisive (Civil Code, Article 1152, paragraph 2); see D. Françon, *op. cit.*, p. 481.

[85] See the references in *supra*, note 2, as well as the description of various legal systems in the I.C.C. Guide, *op. cit.*, pp. 27–51. The Unidroit Principles accept penalty clauses ("agreed payment for non-performance") of both natures (indemnity and deterrent), with, *a posteriori*, judicial control. The specified sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm caused resulting from the non-performance and to other circumstances (Article 7.4.13; cf. M.J. Bonell, Policing the international commercial contract against unfairness under the Unidroit Principles, 3 *Tulane J. Int'l Comp. Law* 1994, 83–85; D. Tallon, Les dommages-intérêts dans les Principes Unidroit relatifs aux contrats internationaux, in *Contratti commerciali internazionali e Principi Unidroit*, M.J. Bonell & F. Bonelli (eds.), Milan, Giuffrè, 1997, pp. 303–304). The Principles of European contract law have a similar provision (Article 9:509); the notes accompanying this article give references to the legal status of penalty clauses in European Union countries (cf. *Principles of European Contract Law*, O. Lando &

penalty clauses inserted in to contracts governed by the laws in question[86], but not necessarily the contracts themselves.[87]

2. Are these solutions covered, however, by international public policy?

No firm answer seems to be available yet to this very delicate question, as there is little case law. First, three positions from French and Belgian authors can be noted.[88] As far as Professor Mercadal is concerned, Article 1152, paragraph 2, of the French Civil Code, which provides that excessive penalty clauses may be reduced, comes under French international public policy; that view is based on the equitable nature of the provision, in accordance with the requirements of international trade, and on the fact that it is in conformity with the majority of foreign solutions.[89] Conversely, Mr. Françon considers that a French court would generally adopt a more moderate approach towards a penalty clause included an international contract than it would in case of a domestic contract, leaving aside certain specific circumstances.[90] As for M.J. Thilmany, he considers that the solutions in question do not fall under Belgian international public policy; the principle of the prohibition of civil penalties has indeed become less rigorous since *astreinte* was introduced in to Belgian law.[91]

As far as case law is concerned, the Working Group was informed of only four decisions. An English court did not find that English law covering "penalties" fell under English international public policy (if this terminology may be used in English law).[92] In contrast, a German decision[93] and a Swiss decision[94] held that the possibility of cutting down excessive

H. Beale (eds.), the Hague, Kluwer Law International, Parts I and II, 2000, pp. 455–456).

[86] However, also note that in German law, by virtue of Sections 348 and 351 of the Commercial Code, penalty clauses applicable to a "*Vollkaufmann*" may not be cut down (see M. Strauch, *op. cit.*, p. 499).

[87] In many legal systems, penalty clauses can be separated from the contract. For instance, under the common law, nullity of the penalty does not result in avoidance of the contract, with the consequence that damages can still be awarded. A contractual "severability" clause can help save the contract when the penalty clause is void; on such clauses, cf. *supra*, pp. 167–176.

[88] See also M. Strauch, *op. cit.*, p. 499, who raises a similar but not identical problem with regard to Section 344 BGB.

[89] B. Mercadal, L'article 1152 al. 2 du Code civil est-il d'ordre public international français? *D.P.C.I.*, 1979, pp. 285–289.

[90] D. Françon, *op. cit.*, p. 481.

[91] J. Thilmany, *op. cit.*, p. 447.

[92] *Godard v. Gray* [1870] L.R.6.QB 139; P. Ellington, *op. cit.*, p. 507.

[93] OLG Hamburg, December 23, 1902, *Seufferts Archiv*, 1902, 63.

[94] Trib. Féd., February 25, 1915, *Rec. Off.* Vol. 41, II, 138.

penalty clauses, as provided by the Codes of those two countries, was a matter of international public policy. These three decisions are relatively old, however.

More recently, the Paris *Cour d'Appel* held that a penalty clause governed by English law, which had been chosen by the parties, was applicable even though English law did not allow the courts to diminish such a clause; in the case in point, application of the clause was not held to be contrary to French international public policy on the grounds that it itself provided for the penalty to be contractually mitigated.[95] One commentator considers that, *a contrario*, had that possibility not existed, the court would have disregarded the foreign law that deprived the court of any power of mitigation.[96]

The solutions adopted are still uncertain. Moreover, any generalization would be dangerous, because of the differences between national laws and the importance the courts will attach to the degree of connection of the contract at hand with the national legal system.

3. Are pains taken, in practice, to avoid to the use of penalty clauses liable to be annulled or cut back? The answer to this question is also difficult. While the Group found numerous clauses in which the penalties provided for seemed to be closely aligned with the actual damage, it was unable to recognize definitely "excessive" clauses in the other part of its sample. In fact, it is very difficult to identify such clauses when they are examined out of context. UNCITRAL made the same finding.[97]

Neither is the terminology used any more enlightening. In particular, the expressions "liquidated damages" and "penalty" are often used indiscriminately, even though these expressions determine whether the clause in question will be found valid or invalid under common law.[98] An example of this confusion follows:

"Section 15. Liquidated Damages.

"This shall comprise the following and be paid in foreign currency.

"15.1. Delay Penalty . . .

"15.2. Performance Penalty . . ."

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[95] Paris, December 22, 1983, *Rev. Crit. Dr. Int. Privé*, 1984, p. 484.

[96] J. Mestre, note, *id.*, pp. 490–491.

[97] First UNCITRAL Report, p. 14, No. 36; Second UNCITRAL Report, p. 6, No. 11.

[98] P. Ellington, *op. cit.*, pp. 507–514; B. Hanotiau, *op. cit.*, pp. 515–524.

Clearly, the court is not bound by the terminology chosen by the parties.

4. Could the parties effectively couple a penalty clause with wording designed to guard against its annulment or risk of being reduced?

Three examples from the Second Report of UNCITRAL's secretariat may be cited:

> "In the event the said liquidated damages are held by a Court of competent jurisdiction to be unenforceable for any reason whatsoever, it is hereby agreed and expressly declared that the aforesaid amounts shall be penalties."[99]

That clause is surprising if common law is applicable to the contract (which is possible since the clause is taken from the sales contract concluded between a North American company and a foreign firm); in principle, the sanction is valid if it actually consists of liquidated damages, whereas penalties are null and void.

- "The rates of agreed and liquidated damages shall not be increased or decreased by arbitration."[100]
- "The contractor is obliged to pay a penalty to buyer that cannot be reduced by any legal procedure."[101]

The usefulness of such stipulations is questionable. The provisions from which the parties intend to derogate are, in principle, binding. The question remains whether or not they are covered by the international public policy of the forum.[102]

(b) The validity of a penalty clause may also be affected by the provisions of the applicable law relating to standard form contracts or unfair contract terms. Several of the monographs on national law allude to this. Specific reference is made to the French law of January 10, 1978 and its implementing decree of March 24, 1978,[103] the British Unfair Contract Terms Act 1977,[104] the German law of December 9, 1976 on general contractual conditions,[105] Section 2-302 of the American Uniform Commercial

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[99] Second UNCITRAL Report, p. 7, No. 12.

[100] *Id.*, p. 21, No. 48.

[101] *Id.*, p. 21, No. 48.

[102] Cf. *supra*, pp. 343–344.

[103] See D. Françon, *op. cit.*, p. 481.

[104] P. Ellington, *op. cit.*, p. 507.

[105] M. Strauch, *op. cit.*, p. 499.

Code as regards the doctrine of unconscionability[106] and the Spanish law of July 23, 1908 on usury.[107] Such regulations may have evolved and others have appeared since those studies were published (the German law on general conditions, for instance, is now incorporated in the BGB). In the European Union, much harmonization has derived from the Directive of April 5, 1993 on unfair terms in consumer contracts.

Some of those provisions are principally concerned with contracts concluded with non-businessmen or consumers, but this is not invariably the case and problems of interpretation exist. Penalty clauses in international contracts could occasionally come under legislation of this type.

(c) Lastly, another type of problem as to the validity of penalty clauses results from the fact that they are frequently used as clauses limiting liability, as observed above.[108] There are restrictions on the validity of the latter type of clauses in most national legal systems, for example, in the case of fraud or gross negligence or where the limitation is such that it undermines the substance of the obligation. We shall be returning to this subject in a later chapter.[109] Here too, negotiators of contracts must be careful. If the penalty clause acts as a clause limiting liability, it will also be subject to the rules governing the latter type of clause, depending on the applicable law.

C. Combination of Remedies

It has transpired from the analysis of clauses that, in some cases, payment of a penalty is stipulated to be capable of being combined with other remedies, such as retention of the obligor's duty to provide specific performance, suspension of the counter-performance, the possibility for the obligee to terminate the contract or the award of additional damages.[110]

Is such an accumulation of remedies legally valid?

It is indispensable to consider the applicable law, since there are numerous differences.

(a) As regards combining a penalty with specific performance, some legal systems distinguish between a penalty imposed specifically for non-performance, which may not be used in combination (see, for example, Article 1229, paragraph 1, of the French and Belgian Civil Codes and Section 340

[106] B. Hanotiau, *op. cit.*, p. 515.

[107] B. Cremades, *op. cit.*, p. 463.

[108] Cf. *supra*, pp. 338–340.

[109] Cf. *infra*, pp. 382–388.

[110] Cf. *supra*, pp. 311–314 and 321–322.

of the German BGB), and a penalty clause relating to delay or defective performance, which may be combined with a right to claim proper performance (Article 1229, paragraph 2, of the French and Belgian Civil Codes; Section 341 of the German BGB).[111] In the first situation, Article 1153 of the Spanish Civil Code adopts the same solution, in principle, which looks unfavorably upon any combination, but agreement to the contrary is expressly authorized.[112] In contrast, some past legislation from Central Europe, specially designed to take account of the needs of international trade, was favorable to the principle of combining penalties and specific performance (Article 192 of the Czech Code of International Trade; Article 304(1) of the East German law on international economic contracts).[113]

Manifestly, these few examples cannot exhaust the multiple facets of this problem in comparative law, but they are enough to illustrate the definite divergences that are encountered when dealing with the problems of accumulation of remedies. UNCITRAL's work with a view to drawing up the text of a uniform law came up against the same divergences; they gave rise to considerable discussions within UNCITRAL itself and prompted numerous differing reactions from governments.[114] It is possible to endorse the opinion of the UNCITRAL secretariat, which considers that many difficulties of interpretation may be avoided by analyzing the function of the clause: did the parties see it as substitute for performance or as a means of compensating for losses incurred pending proper performance?[115] From

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[111] J. Thilmany, *op. cit.*, p. 286; D. Françon, *op. cit.*, p. 481; M. Strauch, *op. cit.*, p. 499.

[112] B. Cremades, *op. cit.*, p. 463. Sections 340 and 341 of the BGB would also not seem to be a matter of public policy according to German commentators (see M. Strauch, *op. cit.*, p. 499).

[113] The problem of combining penalties and specific performance clearly arises in different terms under common law where, in principle, specific performance is not granted (see P. Ellington, *op. cit.*, p. 507).

[114] See Doc. A/CN.9/219 of 28 May 1982, Nos. 26–30, and Doc. A/AC.9/219/Add., of 23 June 1982, No. 7.

The end result of the uniform rules is a subtly qualified text:

"Article 6:

"(1) If the contract provides that the obligee is entitled to the agreed sum upon delay in performance, he is entitled to both performance of the obligation and the agreed sum.

"(2) If the contract provides that the obligee is entitled to the agreed sum upon a failure of performance other than delay, he is entitled either to performance or to the agreed sum. If, however, the agreed sum cannot reasonably be regarded as compensation for that failure of performance, the obligee is entitled to both performance of the obligation and the agreed sum."

[115] Second UNCITRAL Report, p. 17, No. 39.

this angle, combining compensation for delay and specific performance, for instance, would seem to be generally permitted.[116]

(b) On similar grounds, the imposition of penalties for delay seems to be compatible with the option often reserved by the obligee to terminate the contract, in whole or in part, if the delay becomes prolonged. The two remedies are not concurrent; they succeed each other in time.

(c) The suspension of correlative obligations may also be validly combined with the stipulation of compensation for delay. The defense of nonperformance is only a provisional measure. It is a defense plea open to the obligee but not a mode of compensation, it does not play the same role as a penalty.

(d) What about the case where a penalty is combined with additional damages imposed for the same breach? At first sight, such a combination would appear to conflict with the flat-rate nature of the penalty clause. Article 1152 of the Napoleonic Civil Code, in its original version (this provision has been modified in France and abrogated in Belgium), debarred the courts from granting such additional damages.[117] Such a combination is also not allowed under English law.[118] But different solutions are adopted in legal systems, which are not bound by a strictly compensatory concept of penalty clauses, despite the possible infringement on the useful nature of flat-rate penalties. The new Article 1152 of the French Civil Code enables the court to increase a manifestly derisive penalty clause.[119] In Spain, a combination may be agreed upon by contract.[120] In Germany (BGB, Section 340)[121] and Switzerland (Article 161(2) of the Code of Obligations, provided that fault on the part of the obligor is proved), the obligee may obtain additional damages if he proves that he has sustained a higher degree of loss or damage. This solution is also adopted in UNCITRAL's uniform rules (Article 7), provided that the loss alleged is "substantially" higher.[122]

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[116] See to this effect the Hungarian arbitration award cited in the Second UNCITRAL Report, p. 31, No. 67.

[117] See, however, the case law cited by J. Thilmany, *op. cit.*, p. 287, and the distinction introduced by it in order to justify certain such combinations. For France, see the review by B. Mercadal, in *D.P.C.I.*, 1980, 88.

[118] P. Ellington, *op. cit.*, p. 507.

[119] D. Françon, *op. cit.*, p. 481; see also, p. 433, this commentator's arguments in connection with a particular interpretation of the concept of "*astreintes*."

[120] B. Cremades, *op. cit.*, p. 463.

[121] M. Strauch, *op. cit.*, p. 499.

[122] The Benelux Commission (Article 2(2)) and the recommendation of the Council of Europe take the opposite approach.

It is obvious, the various legal systems are very divided in this respect[123] and draftsmen of clauses must pay attention to that. A penalty clause stipulated in a contract clearly does not have the same implications if it calls for a definitive lump-sum payment or if it provides an increase by awarding additional damages. It is important to be aware of the solution adopted under the applicable law, and, if need be, to modify it by contract when the solution is not mandatory.

Moreover, the problem warrants consideration from a specific angle when the penalty clause acts as a clause limiting liability. In such a case, the grant of additional damages seems to be precluded, unless the clause contravenes the principles of the applicable law covering the validity of limitation clauses.[124]

IV. CONCLUSION

The subject of penalty clauses has proved to be a particularly vast one. The very concept of a penalty clause is difficult to tie down. There are similarities with numerous similar mechanisms: clauses "for winding up the contract," liquidated damages clauses, price adjustment clauses, "*astreintes*," etc. A penalty clause may play various roles and, as a result, come under different rules: functions as a threat, as an indemnity, as limiting liability. Delicate problems can arise with regard to combining penalty clauses with specific performance, termination of the contract and the grant of additional damages. The national legal systems often display marked divergences with regard to these aspects and their mandatory provisions may cause some contractual stipulations to be invalid. Furthermore, analysis of penalty clauses, in practice, shows the great wealth of procedures are available to adapt the drafting of penalty clauses effectively to suit the intended aims, the type of contract and the nature of the obligation to which they relate.

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[123] For a broader comparative study, cf. T. Segré, Clause Pénale et dommages ultérieurs en droit comparé, *Rev. Int. Dr. Comp.*, 1970, pp. 299–311; see also the general references to comparative law with regard to the penalty clauses cited *supra*, p. 299–300; see also the few decisions cited in the Second UNCITRAL Report, p. 31, No. 68.

[124] Concerning the mechanism of judicial increase of derisive limitation clauses, cf. Ph. Malinvaud, De l'application de l'article 1152 du Code civil aux clauses limitatives de responsabilité, in *L'avenir du droit, Mélanges en hommage à François Terré*, Paris, Dalloz, 1999, pp. 689–700.

CHAPTER 7
LIMITATION OF LIABILITY AND EXEMPTION CLAUSES

I. INTRODUCTION

The importance of clauses limiting or excluding liability does not have to be demonstrated.

The firm, which sells its products or services, has to face important risks if these products or services prove faulty, or if their performance is unsatisfactory. The warranties and liabilities, which it may have to face, are likely to result in heavy debts—often out of proportion with the importance of its breach or the profit expected from the contract (in many legal systems, the slightest default entails the obligation to indemnify the prejudice fully). In international contracts, such dangers are increased by a greater probability of failure and sometimes also by a lesser knowledge of the foreign legal principles that will govern indemnification.

To limit the scope of the warranty or liability by means of special terms brings indisputable advantages.[1] The obligor discards certain risks, or it makes them foreseeable and bearable. Such limitation of liabilities is sometimes a necessary condition to the performance of especially risky ventures; it can allow innovation and technical progress. It is often required to make the risk insurable, or at least to render the cost of insurance bearable.[2] It may also benefit the other party in the form of a price reduction.

However, there is a darker side to the picture. Limitation and exemption clauses can become abusive when they lead to exaggerated irresponsibility or when they deprive the aggrieved party of lawful remedies. Such concerns have appeared in most legal systems, and the validity of such clauses is limited everywhere. This only increases the interest of our study.

About 150 clauses have been gathered and examined for the present study. These clauses were found in various international contracts. Sales

[1] The technique of limitation and exclusion clauses can be compared to the limitations implemented in economic activities through limited companies.

[2] Such motives also inspire legal limitations of liability such as those provided by most international conventions for the carriage of persons and goods (see e.g., the C.M.R. Convention, Art. 23–25).

and construction contracts are represented, but the sample also contained clauses from other types of contracts, such as loan agreements, agency, renting agreements, counseling, patent or software licensing as well as share transfer agreements.

We shall study first the concept of the limitation or exemption clause, comparing it with closely related clauses (Section II). We shall then analyze the main components of such clauses (Section III). The last part shall consist of additional and critical remarks, including questions related to the problem of validity (Section IV).

A. Notion

The expression "exemption or limitation clauses" calls for some explanations.

1. *Liability and Warranty*

The clauses under scrutiny concern either "liability" or "warranty"; what is to be understood by these terms?

"Liability" (*responsabilité, Haftung*) may be defined as the obligation to compensate for damages caused to another person. This obligation results either from failure to perform a contract (contractual liability) or from a tort (tort liability). Exemption and limitation clauses most often deal with contractual liability arising out of the contract where they are provided. But they sometimes extend to tort liability.[3]

"Warranty" (*garantie, Garantie*), within the present context, refers to the scope of some contractual obligations, especially those borne by the seller concerning defects in the goods sold. The seller is liable for such defects in an objective way, independently from any fault on his part. The law defines the consequences of failure to comply with such an obligation of warranty (in the French Civil Code, the buyer is offered the choice to cancel the sale or to have the price reduced (Article 1644). The concept of fault may reappear if the buyer wishes to go further in his action against the seller (Article 1645, which provides for damages in such a case).

Such is at least the situation in some civil law countries, where warranty rules are exceptions to the general principle of liability based on fault. In common law countries, the situation is different, since all contractual obligations are normally regarded as strict obligations.[4]

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[3] Examples will be given *infra*, pp. 358 and 370; the validity of such clauses will be examined p. 386.

[4] Cf. K. Zweigert & H. Kötz, *An Introduction to Comparative Law*, 3rd ed., 1998, pp. 503–504.

In both systems, however, in spite of the difference just pointed out, "liability" and "warranty" do not stand on the same level. The term "liability" covers the consequences of a breach, whereas the term "warranty" basically refers to the scope of an obligation. Yet, every "warranty" implies consequences, so that the issues also extend to the level of liability. On the other hand, any set of liability rules is subject to certain conditions, among which the scope of the breached obligation is to be found (a breach must be evaluated in comparison with the terms of the obligation). This means that there are close links between the two notions. Clauses dealing either with liability or with warranty will thus be examined simultaneously, but care will be taken to establish the necessary identification.

2. *Clauses Relating to Pre-Contractual Statements*

In some legal systems, or concerning certain contracts, the law indicates the precise consequences if misrepresentations were made by one of the parties at the time the contract was concluded. In English law, the Misrepresentation Act, 1967 stipulates various remedies for such misrepresentations, depending on whether they are fraudulent, negligent or innocent; in some cases, the contract may be avoided and damages granted.[5] In most countries, insurance law provides various remedies for non-disclosure or misrepresentation of fact by the insured, which prevented the insurer from evaluating the risk correctly: depending on the case and on the applicable law, avoidance of the contract, loss of coverage, reduction of the indemnity, change in premiums, etc.[6]

Such consequences are not really part of the contractual liability, since they are remedies to conduct prior to the conclusion of the contract. But they, too, give rise to exemption or limitation clauses in some pre-contractual documents and often in the contract itself.

For example, an advertisement for a product contains the following statement:

> "This information is not to be taken as a warranty or representation for which we assume legal responsibility nor as permission or recommendation to practice any patented invention without a license. It is offered solely for your consideration, investigation, verification and shall form no part of any contract with the customer."

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[5] Cf. Cheshire Fifoot & Furmston's *Law of Contract*, 13th ed., 1996, pp. 273–333.

[6] Cf. M. Fontaine, Le droit du contrat d'assurance dans les pays de l'OCDE. Etude comparative, orientations *de lege ferenda*, in O.E.C.D., *Aspects fondamentaux des assurances*, Paris, 1993, pp. 259–301.

A mining contract stipulates:

> "AI makes no representation or warranty with regard to the property, completion dates, efficacy or efficiency of the equipment, machinery, plant of processes, production quotas, mine yield or other results of the operation of the Facilities."

Some insurance contracts contain clauses of "incontestability" whereby the insurer, under certain conditions, agrees not to invoke non-disclosure or misrepresentation by the insured:

- "Le contrat est incontestable dès le moment de sa souscription, hormis le cas de fraude."
- "S'il est spécifié dans les conditions particulières que la Compagnie a procédé à l'inspection des risques assurés au moment de la souscription de la police, elle renonce à réclamer de plus amples détails et ne peut opposer aucune déchéance due à l'omission ou l'erreur involontaires commises à ce moment dans la description des risques. Toutefois, en cas de constatations ultérieures de pareille omission ou erreur, l'assuré s'oblige à payer les augmentations de primes qui en résulteraient."

Such clauses related to pre-contractual statements do not seem to have been the subject of much attention so far. Should they be subject to the same rules as limitation and exemption clauses? This question shall be discussed below.[7]

3. *Exemption Clauses or Limitation Clauses*

These two types of clauses bring contractual modifications to the rules of liability or warranty provided by the applicable law.

An exemption clause (*clause exonératoire, Haftungsausschlussklausel*) aims at suppressing any liability or any obligation of warranty of the relevant party:

> "Les délais de livraison sont donnés seulement à titre indicatif et sont fonction des possibilités d'approvisionnement. Ils sont respectés dans la limite du possible. Les retards ne peuvent, en aucun cas, justifier l'annulation de la commande ni une demande de dommages-intérêts. Aucune pénalité ne pourra être appliquée en cas de retard, même en cas de mise en demeure."

A clause limiting liability (*clause limitative, Haftungsbegrenzungsklausel*) does not suppress the liability or obligation of warranty altogether, but it

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[7] Cf. *infra*, pp. 387–388.

limits the scope or the consequences of such liability or obligation. Many techniques are available, which will be examined later. Here is a first example of such a clause, where the limitation concerns the amount of damages:

> "The total liability of X and/or the Principals in connection with the Agreement whether in contract or in negligence or otherwise howsoever . . . shall not exceed the sum of 100.000 pounds sterling in aggregate. . . ."

B. Comparisons with Certain Similar Clauses

1. *Liquidated Damages Clauses*

Such clauses are analyzed in another chapter of the present book.[8] They usually stipulate the payment of money in case of non-performance of a contractual obligation. Their first role is to quantify the amount of damages in advance, through the stipulation of a lump sum. For the obligee, they offer the advantage of precluding the possibility of any dispute about the existence or the amount of the damages; when their amount is high, such clauses may also become a means of pressure on the obligor to perform correctly, and a form of penalty in case of breach.[9]

Clauses limiting liability are, at first sight, quite different. They put the obligor, and not the obligee, at an advantage. They do not necessarily consist of a sum limitation. When they do, they set a ceiling, which is often only a maximum, below which, generally, the actual amount of the damages will still have to be determined, while liquidated damages stipulate a lump sum.

Yet, both techniques are at times closely related. Frequently a liquidated damages clause is inspired, not by the obligee, but by the obligor himself—anxious to have the amount of the damages assessed moderately. Such a provision is then very similar to a clause limiting liability, even though the ceiling is replaced here by a lump sum. This phenomenon has already been described in the chapter on liquidated damages clauses.[10]

2. Force Majeure *Clauses*

Force majeure clauses are also analyzed in a later chapter.[11] They provide that in cases where performance is precluded by the occurrence of events outside the obligor's control, and which the obligor could neither foresee nor overcome, the obligor shall be exempted.

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[8] Cf. *supra*, Chapter 6.

[9] This may raise questions of validity, which have been examined *supra*, pp. 338–340.

[10] Cf. *supra*, Chapter 6, pp. 338–340.

[11] Cf. *infra*, Chapter 10.

Whereas exemption or limitation clauses deal with the consequences of breach of contract, *force majeure* clauses deal with cases of non-performance that are not the result of any fault on the obligor's part.

Still, they have common points. First, most legal systems acknowledge cases of faultless liability, in which the obligor is liable even in cases of non-performance resulting from subsequent impossibility (this is the principle accepted in common law). A *force majeure* clause then amounts to an exemption or limitation clause, since it precludes or limits liability in certain situations where the obligor could otherwise be liable.

Secondly, where the applicable law exempts the obligor from liability when non-performance is due to a cause outside his control, there are conditions to be met. A *force majeure* clause, which softens such conditions (by not requesting, for instance, the obligor to prove the unforeseeability of the *force majeure* event), extends the scope of the exemption to cases where the obligor would normally be held liable, thus becoming a variety of exemption or limitation clause.[12]

3. *Hold-Harmless Agreements*

It is not always possible for the obligor to insert a term into the contract exempting himself of all or part of his liability; such exemption is still more difficult to negotiate when it concerns tort liability, which most often arises out of relations with third parties.

To achieve a similar result, the obligor sometimes resorts to another technique, which consists of transferring to the other party the burden of the liability that the obligor would otherwise bear towards a third party. Let us suppose A has a contract with B, which A intends to perform with C's cooperation. In case of defective performance, A would be contractually liable towards B. If A is not able to limit such liability in his contract with B, he can try and obtain C's promise that C will hold A harmless of any claim B (or yet another party) would have against A. Such clauses are often called "hold-harmless agreements," or "contractual indemnity clauses."[13]

Here are a few examples of such clauses:

- "The Consultant shall indemnify and hold harmless the Company from and against any and all claims, damages, expenses and costs,

[12] Cf. *infra*, p. 424; several examples of this situation will be provided *infra*, pp. 364–367.

[13] Cf. National Underwriter Company, Georgia Chapter, *The Hold Harmless Agreement*, Cincinnati, Ohio, 1977; J. Adams & R. Brownsword, Contractual Indemnity Clauses, *Journ. of Bus. Law*, May 1982, pp. 200–209; Y. Aubin & T. Portwood, Les clauses réciproques d'abandon de recours et de garanties contre les recours de tiers, *I.B.L.J.*, 2001, pp. 671–698.

including those asserted by third parties, arising out of its services hereunder, except in respect of defective or erroneous work or as otherwise provided hereunder."

- "Le Fournisseur garantit le Constructeur contre toutes conséquences, directes ou indirectes, de la responsabilité pouvant lui incomber personnellement, notamment celles découlant du non-respect des règles en vigueur dans le pays de destination du véhicule et/ou de ses obligations stipulées par le ou les contrats passés avec le Constructeur, en raison des dommages corporels, matériels ou immatériels causés aux tiers, au Constructeur et à ses ayants cause. A cette fin, le Fournisseur devra s'assurer en conséquence.
- "Le Fournisseur garantit le Constructeur contre toute revendication ou réclamation de tiers relative à son Produit, fondée sur une contrefaçon ou une atteinte à des droits de Propriété Industrielle."
- "The Employer shall indemnify and hold harmless the Contractor, the Contractor's Personnel, and their respective agents, against and from all claims, damages, losses and expenses (including legal fees and expenses) in respect of (1) bodily injury, sickness, disease or death, which is attributable to any negligence, wilful act or breach of the Contract by the Employer, the Employer's Personnel, or any of their respective agents, and (2) the matters for which liability may be excluded from insurance cover, as described in sub-paragraphs (d)(i), (ii) and (iii) of Sub-Clause 18.3 [Insurance Against Injury to Persons and Damage to Property]."[14]
- "Le Licencié devra indemniser, défendre et garantir le Concédant de toute action engagée par des tiers pour des dommages aux biens, des dommages corporels, et les pertes qui en résultent, causés directement ou indirectement par les Produits Licenciés."[15]

Hold-harmless agreements are not exemption or limitation clauses, since they do not affect liability towards the aggrieved obligee. Their technique consists in shifting the burden on such liability to someone else. The effect is similar to that of liability insurance.[16]

II. PRACTICE

The following analysis is an attempt at describing and classifying the different possible components of exemption and limitation clauses,

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[14] FIDIC, *Conditions of Contract for Construction*, 1st ed., 1999, Art. 17.1 al. 2.

[15] ORGALIME, *Model Contract for International Transfer of Technology*, EU/EEA version, June 1997, Art. 10.3.

[16] Other examples of *hold-harmless agreements*, in contracts concerning the exploitation of space, are to be found in P. Thys & M.J. Golub, *op. cit.*, pp. 526 et seq.; L. Ravillon, *Les télécommunications par satellites, Aspects juridiques*, Paris, 1997, pp. 227–228.

with the many variations—some good, some less commendable—found in practice.[17]

A. Exemption Clauses

Exemption clauses are not as frequent as limiting clauses. They are not so easily accepted at the negotiation stage of the contract, and subsequently their validity maybe contested, at least when they bear on the non-performance of essential obligations.[18]

In the first example, a licensor waives all obligation of warranty in case third parties should sue the licensee:

> "RPT shall not be liable to Licensee because of any claim of infringement by Licensee of any third party's patent or patent application by reason of the use of licence herein granted to Licensee."

In the second example, a tax consultant will not accept liability for his lack of knowledge of foreign law, except in specific circumstances:

> "Toute responsabilité du conseiller fiscal du chef de violation ou d'inobservation d'un droit étranger est exclue, sauf si le conseiller fiscal est tenu par un mandat en exécution duquel la connaissance du droit étranger est requise de lui."

An environmental audit is organized in connection with a transfer of shares. The agreement provides that the buyer may request "corrective actions" depending of the results of the audit. The seller exempts himself of all liability in the following case:

> "Y shall not be liable for any corrective action required by third parties or for any fines or damages resulting from a situation or procedure which was identified as problematic in the conclusions of the environmental audit, and for which no corrective action has been required by Y."

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[17] For other surveys of such clauses in practice, cf. J. Livermore, Exemption Clauses in Inter-Business Contracts, *Journ. of Bus. Law*, 1986, pp. 90–102; R.H. Woltjer, Limitations of Liability in Commercial Contracts, in *Structuring International Contracts*, D. Campbell (ed.), Kluwer, 1996, pp. 219–229; H. Dubout, Les clauses de non-garantie dans les cessions de droits sociaux en droit français, *Bull. Joly*, December 1995, pp. 1039–1045; J.M. Mousseron, *Technique contractuelle*, Paris, Ed. F. Lefèbvre, 2nd ed., 1999, No. 1403–1431; J. Rajski, Limitation of Liability and Exclusion Clauses in International Contracts, *I.B.L.J.*, 2002, pp. 321–328.

[18] Cf. *infra*, pp. 382–391.

A frequent situation occurs when the organizer of a show or event exempts himself from liability in case of failure to comply with safety obligations for which he might be held liable:

> "Le porteur du présent ticket renonce, en cas d'accident, à tout recours envers le comité du Salon."

In another case, the manager of a car park exempts himself in case of theft or damage caused to the cars:

> "Le parking décline toute responsabilité concernant les dégâts et le vol aussi bien des voitures que des objets y contenus.
>
> "Nous nous bornons à vous louer un emplacement et nous n'assumons aucune responsabilité de dépositaire."

It appears that the exemption of liability is reinforced by a mention aimed at denying the very existence of the obligation that could cause liability (here the obligation of safekeeping that would derive from a contract of deposit). A similar technique is used in the two following examples, the former concerning the supply of technical assistance and services, the latter the stipulation of delivery dates: in both cases, the "obligation" is stated, but its imperative character is denied.

- "The technical assistance and the services which A undertakes to perform for B in accordance with this Agreement will be of an advisory nature only, and due to this all of the responsibility for the utilization of the technical recommendations provided by A, its employees, its affiliates or their employees in accordance with this Agreement, shall rest solely with B."
- "Les délais de livraison sont donnés seulement à titre indicatif et sont fonction des possibilités d'approvisionnement. Ils sont respectés dans la limite du possible. Les retards ne peuvent en aucun cas justifier l'annulation de la commande ni une demande de dommages-intérêts.
  "Aucune pénalité ne pourra être appliquée en cas de retard, même en cas de mise en demeure."

A chemical firm supplies an engineering company with patents used by the latter to implement specific programs. The custom has been established to increase the price by a "risk margin" aimed at covering possible omissions in the listing of the necessary products. One of the contracts does not include the "risk margin": consequently, the chemical firm exempts itself from the consequences of possible omissions by means of the following exemption clause, the drafting of which could have been more precise:

"Etant donné qu'il n'y a pas eu de "marge d'aléas" prévue par B à la disposition de A, B prendra à sa charge les aléas qui pourraient intervenir (oubli de nomenclature, par exemple)."

The next clause has been discussed extensively by the group:

"B shall bear all liabilities, in contract, in torts (including negligence) or otherwise, for any damage whatsoever, to person or property, sustained during the period of time from the delivery of the prototype by A until restitution of the latter to A pursuant to article 6.

"Accordingly A shall bear no liability whatsoever for any kind of damage, given the fact that the prototypes are delivered 'as such,' that no warranty whatsoever is granted by A with regard to the performance, quality or design of such prototypes and finally that B alone is responsable for installing the prototypes on its facilities and for the testing work to be performed therewith."

The clause appeared in a contract of technical assistance concerning the implementation of a new product. The prototype manufactured by A is delivered to B so that B might test it. A wishes to exempt itself from any liability in case of damage caused by the prototype.

The clause may be effective if B himself is the victim. But what happens if the victim is a third party? If the third party brings an action against B, the clause will preclude any action by B against A. But if the victim brings an action against A (which is lawful as the third party is not a party to the contract), will the clause entitle A to transfer the liability onto B? Does it work then as a hold-harmless undertaking of B towards A? This is unclear, due to imprecise drafting.

B. Limitation Clauses

Limitation clauses may be classified into two categories depending on whether they affect the conditions or the effects of liability or warranty.

1. Limitation of the Conditions

The purpose is to restrict the conditions under which liability may occur. Several techniques are available: limiting the scope of obligations, restricting liability to cases of fraud or gross negligence, extending the cases of exemption, shifting the burden of proof, shortening time limits for acting, subjecting claims to particular requirements.

a. Limitation of the Scope of the Obligations

Exemption clauses often use the technique of denying the very existence or the imperative character of the obligation.[19] The same technique is used in clauses limiting liability. The clause deals directly with the possible cause of liability, i.e., the obligation, to restrict its scope or intensity as compared to what they would normally be under the law.

Very often, professionals define the scope of their obligations by reference to standards such as "general trade standards" or "practices." Such standards have been examined in a preceding chapter.[20] Here are a few examples:

- "Le bureau d'études s'engage à exécuter les études qui lui sont confiées au mieux de son expérience et selon les règles de l'art de l'ingénieur."
- "The Consultant will provide all the expert advice and skills which are normally required for the class of services for which he is engaged."
- "A exercera les missions à elle confiées selon les usages en vigueur dans la profession minière internationale. Toute décision qui pourrait intervenir à l'encontre de ce principe n'engagerait pas la responsabilité de A."
- "A will exercise due diligence in the fulfillment of its obligations in accordance with this Agreement and its performance will be in accord with the regular practices in the petroleum industry."
- "A undertakes to perform its obligations under this Agreement in a prudent and sound manner and to apply the same degree of diligence it would apply it were the sole owner of the Property and the Facilities to be developed in connection therewith, and to be mindful of the interest of B and to use the best copper industry practice known to A which is applicable to this Agreement and the Project."

The party who refers to the rules or usages of its trade often feels safe: it will not require anything beyond normal practice in the trade. One must, of course, assume that the concerned party will effectively comply with such rules or usages, while being aware of possible difficulties related to establishing their existence and their contents.

Are such provisions really equivalent to clauses limiting liability? It all depends on the standards defined by such rules or customs, as compared with the general principles of the law. The liability will be reduced if the

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[19] Cf. *supra*, pp. 358–360.

[20] Cf. *supra*, Chapter 4.

relevant usages are somewhat tolerant as to the quality of the required performance. But it has been shown that more often, the rules of the trade will place greater constraints on the performance required from a professional party.[21]

To define the scope or the intensity of an obligation thus amounts to a clause limiting liability only when it softens the principles applicable in the absence of such a clause.

This happens in a clause limiting the obligation of warranty of a supplier to the working specifications expressly listed in the contract, exclusive of any warranty of fitness of the product to the needs of the buyer:

> "Le fournisseur garantit que le Produit est conforme aux spécifications fonctionnelles figurant en Annexe 1; cette garantie ne saurait en aucun cas être considérée comme une garantie de résultat, portant sur l'adéquation du Produit aux besoins du Preneur."

Another way to limit liability consists of a stipulation transforming an "obligation to reach a specific result" into a mere "obligation of due diligence." For example, a carrier would only undertake to "exert all due diligence" to deliver the goods. An engineer would only undertake to use "his best efforts" when a specific result would normally be expected from him.[22]

Another technique to limit the scope of one's obligations is to specify the conditions under which the agreement will be binding. Such is the technique used by a tax consultant in the following clause:

> "En ce qui concerne les explications et les renseignements donnés oralement par le conseiller fiscal ou son collaborateur, leur responsabilité ne peut être engagée que lorsqu'ils ont été confirmés par écrit."

The above examples concern limitations of a legal nature. But liability or warranty may also be limited by specifications of a technical nature, such as a narrow definition of the expected performance of a machine.

b. Liability Limited to Cases of Fraud or Gross Negligence

Most legal systems will not enforce exemption clauses and clauses limiting liability when the breach is the result of fraud or gross negligence on the part of the obligor.[23]

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[21] Cf. *supra*, Chapter 4, pp. 222–225.

[22] On the distinction between "obligations of best efforts" and "obligations to reach a specific result," cf. *supra*, Chapter 4, pp. 218–222.

[23] Cf. *infra*, pp. 384–385.

Some exemption clauses anticipate this situation and state they do not apply to cases of fraud or gross negligence. Liability is thus limited to such instances, while the exemption concerns other types of breaches.

Here are two examples, both concerning services contracts:

- "A et ses agents ne seront pas responsables vis-à-vis de B de pertes, dommages, obligations ou dépenses encourues ou subies par B directement ou indirectement en conséquence de fournitures de services aux termes du présent contrat, à l'exception de toutes pertes, dommages, obligations ou dépenses résultant directement ou indirectement de la mauvaise foi, de négligence volontaires ou grossières constituant une faute lourde professionnelle de A et ses agents."
- "Neither A, its employees, nor any affiliated company of A or its employees, will be responsible for losses or damages that may be incurred by B or any third party by reason of any action or omission by B, its employees or any third party even though said action or omission was based on technical information or advice furnished by A, its employees, any of its affiliated companies or its employees, in accordance with this Agreement, except if such damages or losses were caused by fraud, bad faith or gross negligence on the part of A or its employees."

In the following example taken from a share transfer agreement, gross negligence is not excluded from the scope of the limitation clause, but only willful misconduct:

> "Exclusive Remedy—The indemnification provisions contained in this Article 10 shall constitute the exclusive remedy of the Parties in connection with this Agreement and the transactions contemplated hereby other than claims arising out of willful misconduct or fraud of a Party."

In other cases, the liability resulting from minor faults is retained with sum limits, and it is these limits that disappear in case of gross negligence:

> "Notwithstanding the above, the limit of cumulative liability under paragraph B shall not apply to CONTRACTOR's liabilities arising from gross negligence and willful acts of CONTRACTOR for which CONTRACTOR's liability under CONTRACT shall be unlimited."

c. Extension of the Cases of Exemption

Possible relationships between *force majeure* clauses and clauses limiting liability have already been considered.[24] A *force majeure* clause results in a limitation of liability when it broadens the scope of the exemption, in comparison with the solutions normally provided by the law.

Here are a few examples:[25]

Sometimes the obligor is not requested to prove the unforeseeable character of the *force majeure* event:

- "In the Contract 'force majeure' shall mean any occurence outside the control of the parties preventing or delaying their performance of the contract. . . ."
- "En cas de survenance d'événements indépendants de la volonté des parties et d'impossibilité d'exécution totale ou partielle par une des parties engagées par la présente convention. . . ."

In other instances, the obligor is not requested to prove that the *force majeure* event was unavoidable:

> "The contracting parties are relieved of their obligations for partial or complete failure to comply with the contract liabilities with regard to the delivery terms if such failure is due to force majeure. Force majeure regards all circumstances occured after the signature of the contract and as a result of any event of exceptional nature, that could not have been anticipated by the contracting parties at the signature of the contract. . . ."

In still other cases, the terms of the contract bear no mention of the consequences of *force majeure* on the performance of the contract:

> "On entend par force majeure pour l'exécution du contrat tous les événements indépendants de la volonté des parties, imprévisibles ou, si prévisibles, inévitables."

Such omissions may be involuntary; but some may reflect a desire to soften the strictness of the classical requirements of *force majeure*. Such a desire is more obvious in clauses that qualify the usual criteria to soften their rigidity.

The concept of unavoidability, for instance, is softened in the following clause:

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[24] Cf. *supra*, pp. 355–356.

[25] These examples will be considered again *infra*, pp. 403–406.

> "On entend par force majeure pour l'exécution du contrat tout acte ou événement imprévisible, irrésistible, hors du contrôle des parties et qui ne pourra être empêché par ces dernières malgré des efforts raisonnablement possibles."

The concept of reasonableness can also help to soften the rigidity of the unforeseeable character of the *force majeure* event:

> ". . . tout événement, circonstance ou état de fait que le vendeur ne pouvait raisonnablement ni prévoir, ni empêcher et auquel il lui a été impossible de porter remède de manière à pouvoir respecter les délais contractuels de livraison."

Most of the time, however, the softening of requirements affects the impact of the *force majeure* event upon the contractual obligations. Absolute impossibility of performance is not always required:

- "On entend par force majeure . . . tout acte ou événement imprévisible, irrésistible et indépendant de la volonté des parties rendant momentanément humainement impossible l'exécution de leurs obligations ou de certaines d'entre elles."
- "Sont considérés comme cas de force majeure ou assimilés, outre les cas communément admis par la jurisprudence belge et française . . .
  (list of events)
- ". . . et en général, toutes les causes étrangères à la volonté ou à l'influence des contractants qui pourraient mettre obstacle à la marche normale de l'approvisionnement, de la fabrication ou des expéditions des contractants."
- "If either party is prevented or delayed in carrying out any of the provisions of this Agreement by reasons of . . .
  (list of events)
- or any event beyond its control making it impossible or exorbitant from an industriel or commercial standpoint to perform its obligations hereunder. . . ."

In the last example given, the usual concept of *force majeure* is modified in two ways: the clause softens the requirement of "impossibility of performance," and it does not mention the criterion of "unforeseeableness."

The effect of such clauses is to exempt the obligor in cases where the law would normally hold him liable.

Close to these are the clauses that establish lists of cases in which a warranty does not apply and add to the number of exemptions defined, by the

law (buyer's fault, subsequent impossibility, etc.), certain other circumstances where the warranty would normally apply. The following example shows how the warranty may be further limited by excluding damages due to accidents as well as breakdowns resulting from the use of appliances not in conformity with the norms:

> "La garantie ne comprend pas la réparation des pannes dont la cause n'est pas imputable au fabricant et notamment:
>
> "la réparation des dégâts résultant d'une fausse manœuvre caractérisée du personnel du client, d'un accident, d'une négligence, d'une utilisation anormale, de la malveillance ou d'actes de sabotage, fait de grève, d'émeutes ou de guerre, ni de la réparation de tous les dégâts provoqués par l'eau, les chutes et chocs brutaux, l'effondrement des locaux, et d'une façon générale, tous accidents ou sinistres susceptibles de détériorer l'équipement;
>
> "la réparation de toute panne prenant son origine dans une installation électrique ou télégraphique défectueuse du client, dans la qualité du courant fourni ou dans des conditions d'installation non conformes aux spécifications indiquées par le FABRICANT;
>
> "la réparation de toute panne due à l'utilisation de fournitures ne répondant pas aux normes agréées par le FABRICANT;
>
> "la réparation de toute panne due à des matériels ou dispositifs non fournis par le FABRICANT et raccordés à l'équipement sans autorisation écrite préalable du FABRICANT."

d. Transfer of the Burden of Proof

Allocation of the burden of proof plays an important part in a liability system. For instance, must the obligee prove that the fault of the obligor, or shall the fault be simply assumed in case of non-performance, in which case the obligor would have to prove that the supervening cause was outside his control to be exempted?

The applicable law establishes the relevant principles. Under French law, for instance, the distinction between "obligations of due diligence" and "obligations to achieve a specific result" coincides with different allocations of the burden of proof.[26]

When the law lays the burden of proof on him, the obligor may restrict his liability by transferring that burden onto the other party. This is achieved, for instance, by clauses that turn an "obligation to achieve a spe-

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[26] Cf. F. Terré, Ph. Simler & Y. Lequette, *Les Obligations*, 6th ed., No. 552–566; cf. also *supra*, Chapter 4, pp. 218–222.

cific result" into an "obligation of due diligence." Another example is given in this clause appearing in a fire insurance contract, through which the insurer rids himself of the burden to prove the exemption case justifying denial of coverage:

> "Les dispositions ci-dessus du 7° ne constituent qu'une énumération d'exclusions mais ne concernent pas la charge de la preuve. En ce qui concerne celle-ci, il est convenu qu'elle incombe exclusivement à l'assuré qui doit établir que les dommages ne se rattachent ni directement ni indirectement aux cas prévus par l'énumération. L'indemnité n'est due que si cette preuve est faite."

e. Limitations of Time Periods to Take Action

Liability and warranty are also limited in time. The statute on limitation in itself constitutes a legal limit to liability: after a certain period of time the obligor can no longer be sued by the obligee. In French law, the buyer can invoke the warranty concerning latent defects only within "a short term" (Article 1648 of the Civil Code).

Inasmuch as such time limits may be validly abridged, the obligor enjoys another means of limiting his liability (or warranty).

This technique is often used to limit the warranties offered by the seller:

- "The warranty contained in Conditions 12.2 shall apply in respect of matters whereof the Customer gives written notice within (12) months of performance of the Services given rise to the Customer's claim after which any claim in respect thereof or in respect of any parts supplied shall be absolutely barred."
- "1. The Contractor shall warrant each Unit for a period of one (1) year from the date of first synchronization against defects in design, materials and workmanship.
  "2. However, such warranty period shall in any case expire fifteen (15) months from the date of readiness for shipment ex works of the generator in case shipment, transportation, erection, commissioning, field test or first synchronization are delayed, unless the reason for such delay is attributable to the Contractor, in which case the warranty period shall be extended by the amount of such delay."
- "La garantie du tube est limitée à six mois ou 1.000 (mille) heures de fonctionnement."

This technique can also assume other forms, as in the three following clauses, respectively taken from an insurance contract, a contract between a solicitor and his client and a contract for software licencing:

- "Toute action en paiement des dommages est prescrite après un délai de six mois à compter du jour du sinistre ou des dernières poursuites judiciaires. Ce délai expiré, la Compagnie est déchargée aussi bien envers l'assuré qu'envers tous opposants, cessionnaires ou bénéficiaires."
- "Les créances de l'avocat contre son mandant se prescrivent par deux ans . . . Ce délai court à dater de la fin de l'année pendant laquelle le mandat a pris fin. Ce délai ne s'applique pas si la prescription prévue par la loi est plus courte. La créance du mandant du chef de dommages et intérêts, résultant du contrat existant entre l'avocat et lui, se prescrit par 3 ans, à dater de la naissance de la créance et, au plus tard, à dater de la fin du mandat."
- "The Lead X Company warrants that any particular copy of a X Software Product will perform substantially in accordance with the applicable user documentation published by X for a period of ninety (90) days from the date an Enrolling Customer ordered, or was required by Section 5 above to order, a License for such copy."

f. Subjection of the Claim to Special Requirements

A subtle means of limiting one's liability is to impose certain formal requirements, or the payment of certain costs, in order to put obstacles in the way of the dissatisfied obligee intending to exercise a claim. Here are examples of such a technique:

- "Any claim made under the guarantee should be submitted to us without delay in writing, enclosing all grounds for the complaint. Handing will then occur in accordance with the procedure determined by us. Goods for which a claim under guarantee has been made, should be sent carriage paid to us, only following our specific request for their return."
- "L'acheteur ou le client est tenu de dénoncer par écrit les vices de la marchandise livrée dans un délai de 14 jours à compter de l'arrivée de celle-ci au lieu de destination. . . ."
- "To qualify for indemnity of the damages covered by this Guarantee, the following terms and conditions have to be fulfilled:
  "a) the storage of the roofing membrane has been done as instructed in the Products Information Sheet issued by . . . ;
  "b) the total amount of the invoice of . . . has been settled;
  "c) the registration form has been submitted to . . . at least fourteen days before the beginning of the works;
  "d) every departure from the installation instructions is previously reported in writing to and approved by . . . ;
  "e) after issuing the certificate of Guarantee neither the contractor nor a third party is allowed to carry out any repair work with-

out the prior written consent of . . . , save as of the repair mentioned in following paragraph;
"f) the owner of the object is obliged to make regular inspections on the roof and make all necessary arrangements in case of damage, in order to protect the property from further damage."

2. *Limitation of the Consequences*

The clauses examined here do not affect the conditions under which liability or warranty could be engaged, but they limit the consequences of such liability or warranty. When it is found that the obligor must pay damages, what is the extent of this obligation? Depending on the answer provided by the law, various clauses may limit the extent of the obligor's obligations.

a. Limitation of the Amount Payable

Liability is, most of the time, unlimited: the totality of the damages must be compensated.[27] The obligor thereby runs the risk of being ruined, especially when the potential prejudice is out of proportion with the profit it will derive from the contract. In consequence, one of the most popular techniques to limit liability consists of establishing a ceiling above which the obligor will not be held liable.[28]

Such ceilings are sometimes expressed in absolute figures:

- "The total liability of X and/or the Principals in connection with the Agreement whether in contract or in negligence or otherwise howsoever (including but not limited to the liabilities of X under Articles 1.3 and 1.4 of the Agreement) shall not exceed the sum of 150,000 pounds sterling in aggregate."
- "The total liability of Company Y for all claims in respect of the Warranties shall not exceed . . . EURO."

Yet, quite often, the maxima are calculated with a more objective measure of the interest the obligor has in performing the contract.

[27] However, the different legal systems have restrictions as to the extent to which indirect or unforeseeable damage have to be indemnified (cf. *infra*, pp. 373–378).

[28] It will be recalled that certain liquidated damages clauses may have the function to limit liability (cf. *supra*, pp. 338–340). Legislation can also provide limitations of the amount of liability (cf. *supra*, p. 351, note 2).

The contractual price is often used as a basis to calculate the damages:

- "The total liability of the Contractor to the Employer, under or in connection with the Contract other than . . . shall not exceed the sum stated in the Particular Conditions or (if a sum is not so stated) the Accepted Contract Amount."[29]
- "A shall pay . . . liquidated damages at the rate of one per cent (1 %) of the contractual price per week of delay. . . ."
- ". . . En l'absence d'accord différent, les dommages-intérêts de retard ne dépasseront pas 2 % par semaine de retard sans pouvoir dépasser 20 % de la redevance minimum dès la première année telle qu'elle est établie à la clause 19."[30]
- "X shall be held liable for direct proven damages arising from proven mistakes by . . . concerning the supply of written technical data and information furnished to Licensee for a specific project under this Agreement up to a maximum amount of twenty-five percent (25%) of the Royalties to be paid by Licensee for the said project."
- "Dans le cas où C n'assumerait pas ses obligations contractuelles définies à l'Annexe 1 ci-jointe, le seul recours du Client sera le droit de recouvrer un montant équitable qui n'excédera cependant pas les montants payés à C et relatifs à de tels Services."
- "The liability of M for negligence shall not, in any event, exceed the amount paid by Representative to M hereunder during the six (6) months period preceding the month in which the loss is alleged to have occurred."
- "Seller's total liability to Buyer for all claims of any kind, whether based upon contract, tort (regardless of the degree of fault or negligence) or otherwise for any loss or damage arising out of, connected with, or resulting from the performance or breach of these Conditions of Sale or any Purchase Order hereunder shall in no case exceed the amount of the price of the specific Product or service which gives rise to the claim."

The same technique is also used in contracts with consulting engineers, who usually limit their liability to the amount of their fees:

- "En tout état de cause, la responsabilité du bureau d'études pour un dommage survenu restera dans un rapport équitable avec le montant des honoraires perçus, sans jamais dépasser le montant de ces honoraires."

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[29] FIDIC, *Conditions of Contract for Construction,* 1st ed., 1999, Art. 17.6.

[30] Orgalime, *Model Contract for International Transfer of Technology,* EU/EEA version, June 1997, Art. 10.2.

- "La responsabilité de la société d'études sera, en tous les cas, limitée, d'une part à la réparation des dommages directs causés et, d'autre part, au montant des honoraires convenus pour l'ouvrage en cause ou, dans le cas où il aurait été stipulé des honoraires fractionnés pour chaque mission, au montant des honoraires stipulés pour la mission au cours de laquelle la faute aurait été commise."[31]

In the following example, the client has obtained that such limitation of liability linked to the remuneration be limited to contractual liability, and that is applied reciprocally:

> "1. Without prejudice to Articles . . . , Company's contractual liability shall be limited in amount to fifteen per cent (15%) of the Contract Price.
>
> "2. Without prejudice to Article 23.4 concerning re-performing of Corrective Services and to Article 35.2, Engineer's contractual liability shall be limited in amount to fifteen per cent (15%) of the Contract Price."

A more sophisticated clause sets limitations only over and above certain of the contractor's obligations, and the sums he may himself recover from vendors, sub-contractors and insurers:

> "B) CONTRACTOR'S liabilities to OWNER with regard to
>
> "a) breach or default by CONTRACTOR in fulfilling warranties and guarantees pursuant to paragraphs 1 and B of ARTICLE 17—WARRANTIES AND GUARANTEES.
>
> "b) Claims, damages and costs awarded against OWNER for patent infringement pursuant to paragraph A-3 of ARTICLE 18—PATENTS AND TECHNICAL INFORMATION.
>
> "c) Indemnification for claims of third parties against OWNER pursuant to paragraph D of ARTICLE 19—CONTRACTORS'S RESPONSIBILITY
>
> shall be limited to a cumulative maximum amount of nine hundred million Italian Lire (Lit 900,00,000).
>
> "C) The limit of cumulative liability under paragraph B shall be over and above CONTRACTOR's own services to be performed

[31] On the limitation of liability of consulting engineers, cf. A. Hubert, *Le contrat d'ingénierie-conseil*, 2nd ed., 1984, pp. 82–86.

pursuant to above paragraph B-a plus any indemnification recovered from vendors, subcontractors (contracted in name and on behalf of . . . and insurances carried by CONTRACTOR pursuant to the CONTRACT."

The seller remains thus obliged to provide his warranty, and it must transfer to the buyer all indemnities that he might himself receive from third parties. It is only over and above these sums that the limitation of liability shall apply.

An original system is that of a "scaled limitation." If buyers of shares have to cope with claims from third parties (in this case, claims caused by damages to the environment resulting from a situation that existed before the transfer and had not been disclosed), the seller's liability is limited in the first stage but it gradually increases with the passage of time:

". . . the Seller shall assume part of the obligation to reimburse the Buyer . . . in accordance with the following scheme:
"for expenses in the course of 1991: 20 %;
"for expenses in the course of 1992: 40 %;
"for expenses in the course of 1993: 60 %;
"for expenses in the course of 1994: 80 %;
"for expenses in the course of 1995 and following years: 100 %."

b. Liability Deductible

Limitation of liability can take on the form of a treshold rather than a ceiling:

"Seller shall not be liable for any claim under any of the Warranties until the aggregate amount of the liability in respect of all such claims exceeds . . . EURO in the case of COMPANY X acting as a Seller and . . . EURO in the case of COMPANY Y acting as a Seller (in which event Buyer shall be entitled to claim the whole amount of such claim and not just the excess)."

The last provision in parentheses brings useful clarification, which will avoid the problem of interpretation that frequently appears with deductibles.

The following clause provides for a double deductible:

"The warranties shall not be triggered unless the double condition that the cumulative amount having given rise to the claim is greater than R$ . . . , and that the amount of each of the losses giving rise to a claim is equal to a minimum of R$. . . ."

Deductible and maximum can be combined:

> "17.4. Neither . . . nor any other company of the . . . Group shall have any obligation to indemnify . . . or any other company of the . . . Group for matters related to the Business beyond a total amount of DEM . . . in the aggregate for all claims made for such matters, provided that the DEM . . . aggregate referred to under Section 3 shall not be exceeded thereby.
>
> "Companies within . . . Group shall not be entitled to indemnification unless the aggregate total amount of their claims amounts to at least DEM . . . In case the aggregate amount of the damages suffered by companies within . . . Group exceeds such amount, companies within . . . Group shall be indemnified for the full amount of the damages suffered by them up to the maximum amount of DEM . . . to the extent as provided hereabove."

c. Exemption of Joint Liability

When an obligor is liable jointly and severally, he is liable for the whole damages. Where joint liability is applicable (as a consequence, for instance, of a statutory provision), any contractual statement, which sets it aside, is similar to a clause limiting liability.

Here is an example taken from a co-insurance contract:.

> "L'assurance est souscrite par chacun des coassureurs pour ses part et portion et sans solidarité, aux mêmes clauses et conditions que celles d'application entre la Compagnie et l'assuré."

d. Exclusion of Consequential Damages

Beyond damages resulting directly from the non-performance of a contractual obligation (for instance, defects in the supplied product or in the building), default on the obligor's part often causes consequential damages to the obligee. The poor quality of a machine may result in an interruption of the assembly line. One of the tires of a plane explodes when landing, provoking the loss of the plane and the death of many passengers.

Such damages may be very serious, in comparison to both the direct damages and the interest the obligor derives from the contract. Most of the time they are very difficult to foresee.[32]

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[32] Unforeseeable damages will be examined more specifically *infra*, pp. 377–378.

Liability for indirect damages is a classical—and difficult—issue in all legal systems.[33] In view of the possible lack of certainty of the remedies granted by the law, many clauses limiting liability exempt the obligor from any liability for consequential damages.

Such exclusion may take various forms. It is implicit when liability is expressly limited to the payment of direct damages:

- "Le bureau d'études assume l'entière responsabilité des dommages directs résultant d'erreurs ou omissions dont seraient entachés les études, calculs, plans et autres documents fournis par lui en exécution du présent contrat."
- "In providing the Services, the Consultant's sole liability in respect of defective or erroneous work shall be to correct or refurnish without cost to the Company any particular item of Services rendered hereunder which proves defective or erroneous and is so notified to the Consultant by the Company from the Effective Date up to the period ending twelve months after submission of the Final Report."
- "En cas d'échec du Constructeur dans les opérations de Réception Définitive prévues à l'Article 18.4 ci-dessus, ou a fortiori si le Constructeur n'était pas en mesure de procéder aux opérations de Réception Définitive conformément aux dispositions de l'Article 14.4 ci-dessus, le Constructeur indemnisera EMIR du Préjudice direct subi par elle du fait du non-accomplissement par le Constructeur de la totalité des obligations lui incombant aux termes de la présente convention.
- "A cet effet, il est expressément convenu que la réparation du préjudice direct subi par EMIR comprendra. . . ." [This is followed by an enumeration of categories of damages considered as direct damages.]

In this clause bearing reference to Article 1150 of the French Civil Code, the exclusion of consequential damages is clear but discrete:

> "Les pénalités prévues au présent article constituent les seuls dommages-intérêts susceptibles d'être réclamés par le client conformément aux dispositions des articles 1150 et suivants du Code civil."

Most of the time, the exemption is explicit, but its expression may take different forms:

- "En tout état de cause, le préjudice indirect n'est pas couvert par le bureau d'études techniques."

[33] Cf. *infra*, pp. 391–394.

- "In no event shall either party be liable for special, indirect or consequential damages."
- "The Contractor's liability under the Article 32 shall be exclusive and in lieu of any conditions or warranty implied by law (including IMPLIED WARRANTIES OF FITNESS FOR PURPOSE AND MERCHANTABILITY) and save as in said Articles expressed neither the Contractor nor his Sub-Contractors, servants or agents shall be liable, whether in contract, tort or otherwise in respect of defects in or damages to such part, or for any injury, damage or loss of whatsoever kind attributable to such defects or damage. All such liability shall terminate upon expiration of the warranty period."
- "La responsabilité des parties ne couvrira en aucun cas des dommages spéciaux, immatériels, incidents ou indirects."

Other clauses again exclude liability for consequential damages, but the exemption does not apply to cases of fraud or gross negligence.

- "Toutes les autres revendications de l'acheteur, en particulier la revendication de dommages et intérêts du fait du dommage indirect, sont à exclure si elles sont fondées sur une violation contractuelle positive.[34] Cette limitation ne s'applique pas si la violation du contrat résulte d'une négligence grave ou d'une faute intentionnelle."
- "Neither Party shall be liable to the other Party for loss of use of any Works, loss of profit, loss of any contract or for any indirect or consequential loss or damage which may be suffered by the other Party in connection with the Contract, other than under Sub-Clause 16.4 . . . and Sub-Clause 17.1 . . .
  ". . . This Sub-Clause shall not limit liability in any case of fraud, deliberate default or reckless misconduct by the defaulting Party."[35]
- "After taking over and save as in this Clause expressed, the Contractor shall be under no liability even in respect of defects due to causes existing before taking over. It is expressly agreed that the Purchaser shall have no claim in respect of personal injury or of damage to property not the subject-matter of the Contract arising after taking over nor for loss of profit unless it is shown from the circumstances of the case that Contractor has been guilty of gross misconduct."[36]

[34] On the notion of "positive contractual breach" in German law (before the reform of 2002), cf. Palandt, *op. cit.*, pp. 346–350.

[35] FIDIC, *Conditions of Contract for Construction*, 1st ed., 1999, Art. 17.6.

[36] U.N. Economic Commission for Europe, *Conditions No. 118a*, Art. 23.14.

The above-mentioned clauses only refer to consequential damages in an abstract manner. This concept being likely to give rise to problems of interpretation, the parties think it fit, in many cases, to establish a list of the various types of indirect damages covered by the exemption. Among these, one shall notice loss of profit, cost of replacement supplies, damage caused to goods other than those supplied and claims by third parties. Here are a few examples:

- "To the maximum extent permitted by applicable law, in no event shall the Lead X Company or any X group company or X's suppliers be liable for any indirect damages (including, without limitation, consequential damages, damages for loss of profits or revenues, business interruption, loss of business information, or other loss) arising under or in connection with this Master Agreement, and Enrollment Agreement, or the products licensed hereunder, even if advised of the possibility of such damages. The limitation of liability set forth in this section is not applicable to the extent damages are shown to be caused by intentional misconduct or gross negligence of the Lead X Company or any X group company or any of their senior management personnel."
- "Neither X nor the Principals shall in any circumstances be liable in contract or tort or otherwise to the Client for any loss of investment, loss of contracts, loss of production, loss of profits, loss of time, loss of use or any consequential or special loss or damage howsoever caused or arising, directly or indirectly sustained by the Client or by any other person, company or corporate body whatsoever."
- "On no account, whether as a result of breach of contract, warranty, torts (including negligence) or otherwise shall either party be liable for special incidental, indirect or consequential damages of any nature whatsoever, such as but not limited to: loss of profit or revenue or clients, loss of use of plants or facilities or any associated equipment, capital costs, costs of substitute equipment, facilities or services, cost of purchase or replacement of gas, oil electricity, etc. . . . , loss of or damage to property or equipment other than the delivered products, etc. . . ."
- "In no event, whether as a result of breach of contract, tort liability (regardless of the degree of fault or negligence) or otherwise, and whether arising before or after completion of Seller's obligations under these Conditions of Sale or any Purchase Order pursuant thereto, shall Seller be liable to Buyer for losses or damages caused by reason of unavailability of the Plant, Plant shutdowns or service interruptions, (including, but not limited to, loss of use, profits or revenue, inventory or use charges, cost of purchase or replacement power, interest charges or cost of capital, or claims of

Buyer's customers), or special, consequential or penal damages of any nature."

Indirect damages may include bodily damages. However, such type of prejudice seldom appears in lists of excluded damages, probably because such a provision would often be invalid.[37]

The following clause institutes an interesting system: the exclusion of indirect damages is itself set aside inasmuch as the obligor is able to recover them from his insurer or his contractual partners:

"CONTRACTOR shall not be liable for any loss sustained by OWNER of its anticipated profits from operation of PLANT or other consequential damages except to the extent CONTRACTOR may recover such losses from insurances carried by CONTRACTOR pursuant to the CONTRACT, vendors, subcontractors, renters of construction tools and equipment. CONTRACTOR shall exert all reasonable efforts and diligence to recover such losses from such parties. In case such parties have to be sued, CONTRACTOR has first to reach agreement with OWNER; costs of action are on OWNER's account."

e. Exclusion of Unforeseeable Damages

Is the obligor liable for unforeseeable damages, or is he only liable for the damages that he could foresee as a consequence of his breach? This is another classical issue of the law of liability.[38]

This problem is sometimes confused with the question of indirect damages. It is true that the more indirect the damages, the less likely they are foreseeable. Yet, this is not always the case. Direct damages can be unforeseeable, while certain types of indirect prejudices may be anticipated easily.

Unforeseeable damages are less often envisaged in contractual clauses than indirect damages. However, drafters do well to consider them, since some direct damages may take an unforeseeable development and thus deserve particular attention when drafting clauses concerning liability.

An already mentioned clause, which refers to Article 1151 of the French Code, deals with this problem:

"Les pénalités prévues au présent article constituent les seuls dommages-intérêts susceptibles d'être réclamés par le Client

[37] Cf. *infra*, p. 386.

[38] Cf. *infra*, pp. 391–394.

conformément aux dispositions des articles 1150 et suivants du Code Civil."

The foreseeable character of the damages is alluded to in the next clause, which considers various possibilities:

"Toute revendication de dommage et intérêts par le client, quel que soit son fondement, qu'elle ait un rapport direct ou indirect avec la commande, qu'elle trouve sa source dans la livraison ou l'utilisation de notre matériel, est à exclure dans la mesure où nous, nos employés ou nos mandataires n'avons pas occasionné le dommage par notre négligence grave ou intentionnellement.

"En cas de négligence grave ayant entraîné un dommage, la revendication de dommages et intérêts par le client qui est commerçant ne peut dépasser l'indemnisation du dommage prévisible. Une revendication de dommages et intérêts formulée par un client qui n'est pas commerçant, du chef de retard ou d'impossibilité d'exécution suite à une négligence légère, ne peut dépasser le quart du prix d'achat de ladite marchandise."

The problem of unforeseeable damages is dealt with in Article 26, 1 of General Conditions 188A of the Economic Commission for Europe:

"Dans le cas où l'une des parties est tenue envers l'autre à des dommages-intérêts, ceux-ci ne peuvent excéder la réparation du préjudice que la partie fautive pouvait prévoir lors de la formation du contrat."

f. Limitation of the Warranty to Refund, Replace or Repair the Object Concerned—Clause of "Exclusive Remedy"

The warranty obligation of the seller varies according to the different legal systems, but the buyer usually has several possible remedies. In French law, for instance, he has a choice between avoiding the sale or having the price reduced (Article 1644 of the Civil Code); and if the seller has acted in bad faith, the buyer may additionally claim damages (Article 1648). Usual terms of warranty generally limit the seller's obligation to the refunding, replacing or repairing the object, thus excluding any other remedy provided by law.

Here are several examples of such clauses:

- "Materials and articles sold or furnished by Buyer to Seller for the performance of the Order shall be inspected and accepted by Seller prior to use or processing, and Buyer's responsibility for

defects is limited to replacement of such materials or articles or their value."

- "Every new aircraft tire or tube, manufactured by F. bearing that name and their serial number is guaranteed to be free from defects in workmanship and material. If our examination shows that such tire or tube has failed under the terms of this guarantee, we shall either repair it or make a reasonable allowance on the purchase of a new tire of same size, ply rating and speed rating. "There is not other warranty or guarantee, express or implied, applicable to these products."
- "The sole liability of A hereunder shall be the repair and/or replacement of Products, or parts thereof, returned to a North American or European Manufacturing or Distribution Centre of A following written notice of the defect given within the Warranty Period. The repair and/or replacement shall be at the expense of A, provided that examination of the Products or parts thereof by A, discloses that the Products of parts thereof are defective in material and/or workmanship. In any event, all shipping costs to a North American or European Manufacturing or Distribution Centre of A shall be borne by the Distributor.
  "Notwithstanding anything contained herein, A may authorize the Distributor to repair and/or replace the defective Products, or parts thereof, without their being returned to a North American or European Manufacturing Centre of A. However, the provisions of this paragraph shall apply only in the event that the Distributor, prior to carrying out such repair and/or replacement, has obtained the written consent of A, which consent may be refused for any reason whatsoever. The failure to obtain such prior written consent shall be an absolute bar to any recovery by the Distributor and/or any third party in respect of alleged defect in material and workmanship."

Similar stipulations appear in contracts other than sales, to exclude any other remedy than the modes of repair accepted by the obligor:

- "Exclusive Remedy—The indemnification provisions contained in this Article 10 shall constitute the exclusive remedy of the Parties in connection with this Agreement and the transactions contemplated hereby other than claims arising out of willful misconduct or fraud of a Party."
- "En raison du caractère particulier des services liés au lancement d'une fusée porteuse vers l'espace, les parties ont convenu que la responsabilité d'Arianespace et de son client du fait de l'inexécution de leurs obligations contracuelles est strictement limitée aux oonséquences expressément prévues dans le présent contrat, à

l'exclusion de toute autre demande en dommages-intérêts ou en indemnités."[39]

g. Limitation of the Warranty as to the Warranty Enjoyed by the Seller Transfer of Warranty

When goods are subject to successive sales, this creates a series of successive warranty obligations, the coordination of which must be carefully examined.

One possibility is to have the warranty offered to the buyer mirror the one enjoyed by the seller himself. Such a stipulation is *per se* a means to limit one's guarantee.

"Notwithstanding anything herein contained, with respect to the Printer and the Disk Drives purchased by the Distributor, and forming part of the Products, the warranty of A shall be limited to the extent that A is able to enforce a claim for liability against the manufacturer of such equipment."

Another technique consists of transferring to the sub-purchaser the warranty for which the first seller is liable.[40] This process is often used in aeronautics, where the manufacturer of an aircraft transfers to the buyer the warranties for which the manufacturers of the various parts are liable. When such transfer is accompanied, at least implicitly, by a waiver of any warranty claim against the manufacturer, we no longer deal with a limitative clause, but with an exemption clause.

This process can be likened to a frequent practice in leasing contracts. The leasing company wishes not to be involved in any litigation about technical issues concerning the machines under the contract. In its sales contract with the manufacturer, it inserts the following clause:

"Article 6. Garanties.

"Le vendeur s'engage à faire bénéficier le locataire de la garantie d'éviction et de la garantie des vices cachés telles qu'elles résultent de la présente commande, de la loi et de l'usage. En cas de contestation relative notamment à la construction, au fonctionnement ou au rendement du matériel livré, le locataire agit directement en

[39] Clause quoted by L. Ravillon, *op. cit.*, p. 239.

[40] In certain legal systems, even in the absence of any contractual provision, courts allow the sub-purchaser to exercise a direct claim against the initial seller (cf., under French law, J. Ghestin & B. Desché, *Traité des contrats—La vente*, 1990, pp. 1036–1064).

> garantie en vertu de la stipulation pour autrui dont il bénéficie par les présentes, et du mandat d'agir en résolution de la vente."

On the other hand, the leasing contract signed with the lessee states that the latter will waive any claim against the lessor, since the possibility to act directly against the manufacturer is offered:

> "3.5. Par dérogation aux dispositions de l'article 1724 du Code civil, le locataire renonce à toute indemnité et droit de résiliation vis-à-vis du bailleur, sauf bénéfice de la garantie du vendeur, même dans le cas où le matériel est hors d'usage pendant plus de 40 jours pour quelque cause que ce soit.
>
> "3.6. Contrairement aux articles 1719 et suivants du Code civil, tous les frais nécessités par l'emploi, l'entretien et les réparations du matériel sont à la charge du locataire.
>
> . . .
>
> "4.1. Le locataire déterminant les conditions techniques et financières du contrat de vente en qualité de mandataire du bailleur, d'une part, disposant de la jouissance du matériel dans le cadre des présentes, d'autre part, étant susceptible de lever l'option d'achat stipulée en l'article 8 ci-dessous enfin, bénéficie de la garantie donnée par le fabricant.
>
> "4.2. Afin que cette garantie puisse s'exercer dans les meilleures conditions, le locataire bénéficie, aux termes des conditions générales du bon de commande, d'une stipulation pour autrui, lui permettant d'intervenir directement près du fournisseur et du constructeur, et éventuellement d'exercer tous recours contre eux, dans le seul but d'obtenir la bonne exécution du contrat de vente.
>
> "4.3. Cependant, si le locataire, en sa qualité d'utilisateur du matériel, estime nécessaire d'agir à ses frais en résolution du contrat de vente, le bailleur propriétaire lui donne, à cette fin, par les présentes, mandat d'ester, toutefois révocable pour justes motifs, les impératifs commerciaux étant dès à présent considérés comme tels. Dans l'une et l'autre hypothèse, il doit informer préalablement le bailleur de son action et lui communiquer toutes pièces de procédure lui permettant de préserver ses droits."

III. ADDITIONAL REMARKS AND CRITICAL OBSERVATIONS

The main techniques used in drafting clauses limiting or excluding liability have just been analyzed. Our purpose now is to draw attention to the

problems of validity that may occur in connection with some of the above-mentioned clauses, in the various legal systems (Section III.A), to emphasize the important issue of consequential and/or unforeseeable damages (Section III.B), and to stress the close links between limitation and exemption clauses and insurance problems (Section III.C).

A. Problems of Validity

The validity of clauses limiting or excluding liability will be examined under domestic legal systems (in the European Union, domestic laws integrate certain European directives), various international instruments and private international law.

1. *Domestic Legal Systems—Impact of European Directives*

(a) Limitation and exemption clauses arouse suspicion in most, if not all, legal systems. They are a straightforward derogation of the principles of liability, much influenced, at least in certain legal systems, by the moral values underlying the law of obligations. An obligor in breach should be liable for the damages he causes. At first sight, it should not be allowed to avoid liability. This situation is the more pre-occupying as it is often the result of the dominant position of one of the parties.

Freedom of contract is an accepted principle in most countries, and clauses limiting liability are, *a priori*, valid, but many exceptions are obstacles to this validity. The main characteristic of such restrictions is that they are of a great variety. In comparative law, the rules applicable to such clauses are far from being harmonized. Negotiators of contracts should be aware of this fact. Before drafting such clauses, it is necessary to be fully conversant with the principles within the law applicable to the contract.[41]

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[41] The following presentation will often refer to various studies prepared by members of the Group on their own legal systems, and published with the oiriginal version of this study: P. Larère, Les clauses limitatives et exonératoires de responsabilité en droit français, *I.B.L.J.*, 1985, pp. 479–481; X. Malengreau, La clause d'exonération de responsabilité en droit belge, *I.B.L.J.*, 1985, pp. 483–486; O. Boschetti, Notes on Exemption Clauses under Italian Law, *I.B.L.J.*, 1985, pp. 487–490; R. Pelletier, Les clauses d'exonération et de limitation de responsabilité en droit mexicain, *I.B.L.J.*, 1985, pp. 491–493; M. Strauch, La loi allemande sur les conditions générales et les clauses limitatives de responsabilité, *I.B.L.J.*, 1985, pp. 495–507; L. Arentz-Hansen, The Wingull Arbitration Award of 1978, *I.B.L.J.*, 1985, pp. 509–511; P. Ellington, Exclusion Clauses in English Law, *I.B.L.J.*, 1985, pp. 513–515; B. Hanotiau, Les clauses d'exclusion et de limitation de garantie et de responsabilité en droit américain, *I.B.L.J.*, 1985, pp. 517–523; P.J. Thys et M.J. Golub, Limiting a Seller's Liability under United States Law in Commercial and Government Contracts, *I.B.L.J.*, 1985, pp. 523–528. Those studies were written in 1985 and are not up to date any more. Domestic systems have evolved. In the European Union, the impact of the directives mentioned in the text has been felt. A more recent basic reference, though it is itself more than ten years old, is that of a col-

However, in the European Union, two important directives have brought domestic rules concerning limitation and exemption clauses closer together.

The Directive of April 5, 1993 on unfair terms in consumer contracts[42] considers as unfair, in contracts which have not been individually negotiated, clauses that are contrary to the "requirement of good faith," cause "a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer" (Article 3.1). Member States must provide that such clauses are not binding on the consumer (Article 6). An annex to the Directive gives an indicative, but not exhaustive, list of clauses that may be declared unfair, including certain types of clauses limiting and excluding liability.

On the other hand, the Directive of May 25, 1999 on the sale of consumer goods and associated guarantees[43] provides that under conditions set by domestic law, the consumer is not bound by *any contractual terms or agreements concluded with the seller before the lack of conformity is brought to the seller's attention which directly or indirectly waive or restrict the rights resulting from this Directive* (Article 7).

On the domestic level, rules applicable to clauses limiting or excluding liabilty sometimes derive from general norms. See, for instance, in some of the most important codifications, Section 276, 2° of the German Civil Code, Article 100 of the Swiss Code of Obligations, Article 1229 of the Italian Civil Code, Article 1102 of the Spanish Civil Code and Article 1474 of the Civil Code of Quebec. On the contrary, in countries like France or Belgium, the Civil Code does not mention clauses limiting or excluding liabilty and the applicable solutions are based on case law.

In specific contracts, a greater number of texts regulates the problem of clauses limiting liability. For instance, such clauses in contracts of sale are ruled by Sections 2-316 and 2-719 of the American Uniform Commercial Code.[44] Also see, as examples in Italian law, Articles 1487 et 1490 of the Civil Code (sales), Article 1579 (rent), Article 1681 (carriage),

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loquium organized in Paris in 1990: *Les clauses limitatives ou exonératoires de responsabilité en Europe*, J. Ghestin, (ed.), Paris, 1990, 361 pp. Other comparative reviews are found in E. Von Hippel, The Control of Exemption Clauses. A Comparative Study, 16 *Int. Comp. L.Q.*, 1967, pp. 591–612, and mainly G. Eörsi, The Validity of Clauses Excluding or Limiting Liability, 23 *Amer. J. of Comp. Law*, 1975, pp. 215–235. Cf. also, for an interesting comparative study applied to a particular sector, L. Ravillon, *Les télécommuniations par satellites, Aspects juridiques*, Paris, 1997, pp. 246–287.

[42] *Off Journ.*, April 21, 1993, L. 95/29.

[43] *Off Journ.*, July 7, 1999, L. 171/12.

[44] Cf. B. Hanotiau, *op. cit.*, pp. 517–518.

Article 1713 (agency) and Article 1785 quater (deposit);[45] in Mexican law, Article 15 paragraph 13 of the law on transfers of technology.[46]

Under certain jurisdictions, limitation clauses are also affected by special provisions regulating general conditions or abusive clauses; this is the case in Germany with the law on general conditions of 1976 (*AGB Gesetz*, integrated in the *BGB* since 2002), in England with the Unfair Contract Terms Act of 1977,[47] in France with the Decree of March 24, 1978[48] and in the Netherlands, with Article 237e of the NBW.[49] Some of these texts had to be aligned with the provisions of the European Directive of April 5, 1993 on abusive clauses; EU countries, which did not have such regulations yet, had to implement them.[50]

Rules may be different depending on the expertise of the parties (business professionals or consumers; men of the trade or not). Examples: a presumption of "bad faith" is imposed on the professional seller under French[51] and Belgian[52] law; the German rules on general conditions establish distinctions depending on whether the customer is a tradesman himself or not;[53] the French law on protection and information of the consumer also distinguishes between professional and non-professional parties.[54]

(b) Apart from legal texts, which avoid definite forms of limitation and exemption clauses, the validity of such clauses may be questioned mainly in the following cases:[55]

1. Fraud or wilful breach on the part of the obligor always invalidates clauses limiting or excluding liability. This is probably the only

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[45] Cf. O. Boschetti, *op. cit.*, pp.489–490.

[46] Cf. R. Pelletier, *op. cit.*, p.493 .

[47] Cf. P. Ellington, *op. cit.*, p 514; Cheshire Fifoot & Furmston, *op. cit.*, pp. 184–203; R. Lawson, *Exclusion Clauses and Unfair Contract Terms*, 7th ed., 2003.

[48] Cf. F. Terré, Ph. Simler & Y. Lequette, *op. cit.*, pp. 488, 490–492.

[49] Cf. E. Hondius, Droit néerlandais, in *Les clauses limitatives ou exonératoires de responsabilité en Europe*, J. Ghestin, (ed.), Paris, 1990, *op. cit.*, pp. 291–292.

Cf., for instance, concerning England, the *Unfair Terms in Consumer Contracts Regulation 1994* (Cheshire Fifoot & Furmston, *op. cit.*, pp. 203–205).

[51] Cf. P. Larère, *op. cit.*, pp. 480 et seq.

[52] Cf. X. Malengreau, *op. cit.*, pp. 484–485.

[53] Cf. M. Strauch, *op. cit.*, p. 496.

[54] Cf. F. Terré, Ph. Simler & Y. Lequette, *op. cit.*, pp. 490–491, 492.

[55] This short presentation will be accompanied by references to domestic legal systems; we will give preference to the studies written by members of the working group. These studies were written in 1985; a few more recent references will be added.

point where the solution is unanimous.[56] As has already been mentioned, in some countries, the professional seller is automatically assumed to have acted in bad faith, and this affects the validity of clauses limiting liability.[57]

2. Domestic systems do not agree in the case of gross negligence. Such conduct precludes the application of the clause in Italy,[58] Germany[59] and France,[60] but not in Belgium[61] or Mexico.[62]

   The right to exempt oneself from the fraud or gross negligence committed by one's employees is also assessed differently in different countries.[63]

3. Clauses limiting liability are sometimes set aside when they affect the very substance of the obligation (*obligation vidée de sa substance*)[64] or when they concern a major obligation (*Kardinalpflicht*).[65] The common law has a similar approach under the theory of fundamental breach, but the matter is rather complex.[66] Recently, the French *Cour de Cassation* has ruled against a limitation clause that contradicted the essential character of the undertaking by a specialized firm to deliver mail rapidly.[67]

4. The validity of limitation and exemption clauses is sometimes assessed according to their "reasonableness." This is the case under

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[56] Cf. P. Larère, *op. cit.*, p.479; X. Malengreau, *op. cit.*, p. 484; O. Boschetti, *op. cit.*, p. 487; M. Strauch, *op. cit.*, p. 504; R. Pelletier, *op. cit.*, p. 492; P. Ellington, *op. cit.*, p. 513; B. Hanotiau, *op. cit.*, p.517; L. Ravillon, *op. cit.*, pp. 255–256; J.M. Mousseron, *Technique contractuelle*, Paris, 2nd ed., 1999, No. 1423.

[57] Cf. P. Larère, *op. cit.*, .p. 480; X. Malengreau, *op. cit.*, pp. 484–485.

[58] Cf. O. Boschetti, *op. cit.*, p. 487.

[59] Cf. M. Strauch, *op. cit.*, p. 504.

[60] Cf. P. Larère, *op. cit.*, p. 479; L. Ravillon, *op. cit.*, pp. 256–258; J.M. Mousseron, *op. cit.*, No. 1423.

[61] Cf. X. Malengreau, *op. cit.*, pp. 484–485; G. Eorsi (*op. cit.*, p. 218) points out that this position of Belgian case-law goes against the general tendency, which is increasingly severe towards clauses limitating or excluding liability.

[62] Cf. R. Pelletier, *op. cit.*, p. 492.

[63] Comp. P. Larère, *op. cit.*, pp. 480 et seq. about France, and X. Malengreau, *op. cit.*, p. 484 about Belgium.

[64] Cf. P. Larère, *op. cit.*, pp. 480 et seq.; L. Ravillon, *op. cit.*, pp. 258–260; J.M. Mousseron, *op. cit.*, No. 1425–1426.

[65] Cf. M. Strauch, *op. cit.*, p. 504.

[66] Cf. P. Ellington, *op. cit.*, p. 514; Cheshire Fifoot & Furmston, *op. cit.*, pp. 180–184.

[67] Cass. fr., October 22, 1996, Dall., 1997, J, 121, note Sériaux (Chronopost). On this decision, cf. also J.M. Mousseron, *op. cit.*, No. 1425.

Section 2-316 of the American Uniform Commercial Code,[68] and Section 3 of the English Unfair Contract Terms Act.[69]

5. It is sometimes illegal to introduce a clause modifying the system of tortious liability. This is the case in France[70] and Mexico,[71] but not in Belgium[72] or Italy.[73]
6. Often limitation and exemption clauses cannot be applied when the liability concerns personal injuries. This solution is adopted by the English Unfair Contract Terms Act.[74] It is also applicable in France, in spite of some discussion,[75] but such a restriction does not exist in Belgium.[76] The Directive of April 5, 1993 on unfair terms in consumer contracts avoids clauses *excluding or limiting the legal liability of a seller or supplier in the event of the death of a consumer or personal injury to the latter resulting from an act or omission of that seller or supplier* (Annex, Article 1a).
7. When a clause limiting liability also serves as a liquidated damages clause,[77] it is subject to the solutions that may regulate such clauses in the law applicable to the contract.[78] Article 1152 of the French Civil Code is worth mentioning in this context: this provision empowers the judge not only to decrease an excessive *clause pénale,* but also to increase one that would be manifestly insufficient to compensate for the loss.[79]
8. Compliance with formal requirements may be demanded. See, e.g., Section 2-316 of UCC: any modification to the warranty of merchant quality must use the term "merchantability" and, when it is in writing, it must be formulated in a very apparent manner.[80]

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[68] Cf. B. Hanotiau, *op. cit.*, pp. 517–518.

[69] Cf. P. Ellington, *op. cit.*, p.514.

[70] Cf. P. Larère, *op. cit.*, p. 479; J.M. Mousseron, *op. cit.*, No. 1422.

[71] Cf. R. Pelletier, *op. cit.*, p. 492.

[72] Cf. X. Malengreau, *op. cit.*, pp. 483–485.

[73] Cf. O. Boschetti, *op. cit.*, p. 487.

[74] Cf. P. Ellington, *op. cit.*, p. 514; Cheshire Fifoot & Furmston, *op. cit.*, pp. 188–196.

[75] Cf. P. Larère, *op. cit.*, p. 480 et seq.; J.M. Mousseron, *op. cit.*, No. 1427.

[76] Cf. X. Malengreau, *op. cit.*, p. 484.

[77] Cf. *supra*, pp. 338–340.

[78] On these solutions, cf. *supra*, pp. 342–346, as well as the different studies published in *D.P.C.I.*, 1982, pp. 443–524.

[79] Cf. F. Terré, Ph. Simler & Y. Lequette, *op. cit.*, pp. 493–501.

[80] Cf. B. Hanotiau, *op. cit.*, p. 518; P. Thys & M.J. Golub, *op. cit.*, pp. 524–525.

9. Limitation and exemption clauses may be restricted by the general principles of legislation concerning *unfair terms.*[81] See for instance Section 2-302 of UCC on "unconscionability,"[82] and Section 36 of Norwegian Law of Contracts, which condemns clauses the application of which would be "unreasonable," or contrary to "good trade usages."[83] Such an approach has been generalized in the European Union with the Directive of April 5, 1993.[84]
10. Finally, limitation and exemption clauses, which are part of standard contracts, may have to meet the requirements imposed by some regulations on the validity of such contracts and the clauses they contain. See Article 1341 of the Italian Civil Code, requesting express and written approval of the other party.[85]

On a more general level, limitation or exemption clauses are effective only when the other party has been in a position to consent to them when concluding the contract—a requirement that is not always satisfied in contracts of *adhesion.*[86]

On the other hand, when such clauses are part of pre-established standard general terms, they may often be subject to restrictive interpretation, contra proferentem.[87]

Thus, the techniques used to judge the validity of limitation and exemption clauses are quite diverse and they differ in natures. When drafting such clauses, one should really make sure that they are in accordance with the law applicable to the contract.

The first part of this study mentioned the case of clauses concerning pre-contractual representations, attempting to exempt the beneficiary from the effects of non-disclosure or misrepresentation.[88] Is it fitting to apply the same principles as those that apply to limitation and exemption clauses, and to decide their validity on the same bases?

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[81] Independently of the specific rules on limitation and exclusion clauses which may appear in such regulations (cf; supra, p. 384); an example was given concerning personal injury.

[82] Cf. B. Hanotiau, *op. cit.*, pp. 519–520.

[83] Cf. L. Arentz-Hansen, *op. cit.*, p. 511.

[84] Cf. e.g., about France, J.M. Mousseron, *op. cit.*, No. 1427–1428.

[85] Cf. O. Boschetti, *op. cit.*, p. 488; on German law, cf. M. Strauch, *op. cit.*, p. 499.

[86] Cf. X. Malengreau, *op. cit.*, p. 483.

[87] *Id.*, p. 484.

[88] Cf. *supra*, pp. 353–354.

That question has not yet been sufficiently discussed and it would deserve a more thorough examination under the different legal systems.

In certain cases, similar principles must apply. In insurance contracts, a clause of *incontestability* cannot cover fraudulent non-disclosure or misrepresentation;[89] this is often explicitly specified.

In the above-mentioned clause excluding liability for the technical information contained in an advertisement,[90] the group wondered whether such a clause did not make affect the substance of the obligation. Was it an offer, or simply advertising literature? If it were an offer, even those legal systems, which regard the offer as binding, recognize that this binding character can be set aside by making a non-committal offer.[91] The validity of so-called *entire agreement*, or *four corner agreement* clauses, by which an agreement is limited to what is expressly included in the terms of the contract, thus excluding all pre-contractual documents, is also not questioned.[92]

Such considerations would appear to argue in favor of the validity of the above clause. However, would it still be considered valid if it were invoked in the case of *dol* or *fraudulent misrepresentation*? It would probably be invalidated in the former case, under systems that know the concept of *dol* as a *vice* affecting consent. In English law, Section 8 of the Unfair Contract Terms Act, makes a clause limiting liability or remedies in case of misrepresentation invalid, unless it is reasonable.

2. International Instruments

In some international agreements, the system of contractual liability is a difficult compromise between the interests of the parties, so that contractual deviations are often excluded.

Here are two examples:

- "Any provision tending to relieve the carrier of liability or to fix a lower limit than that which is laid down in this Convention shall be null and void, but the nullity of any such provision does not involve the nullity of the whole contract, which shall remain subject to the provisions of this Convention" [Art. 23 of the Warsaw Convention on air transport].

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89 Cf. Y. Lambert-Faivre, *Droit des assurances*, 10th ed., 1998, No. 915.

90 Cf. *supra*, p. 353.

91 Cf., for instance, about Section 145 of the BGB, D. Medicus, *Allgemeiner Teil des BGB*, 5th ed., 1992, p. 137.

92 On such clauses, cf. *supra*, Chapter 3.

- "1. Subject to the provisions of article 40, any stipulation which would directly or indirectly derogate from the provisions of this Convention shall be null and void. The nullity of such a stipulation shall not involve the nullity of the other provisions of the contract. "2. In particular, a benefit of insurance in favor of the carrier or any other similar clause, or any clause shifting the burden of proof shall be null and void" [Art. 41 of the C.M.R. Convention on road transport].

The Unidroit Principles on International Commercial Contracts contain the following provision on exemption clauses:

> "A clause which limits or excludes one party's liability for non-performance or which permits one party to render performance substantially different from what the other party reasonably expected may not be invoked if it would be grossly unfair to do so, having regard to the purpose of the contract" [art. 7.1.6].

The Principles have elected to retain "gross unfairness" as the standard for invalidity, thus introducing yet another approach to the other common criteria, indicated above.[93] The solution has been criticized.[94]

The Principes of European Contracts nevertheless resort to a similar standard. They provide that "A clause which limits or excludes one party's liability for non-performance may not be invoked if it would be grossly unfair to do so" (art. 8.109).

3. *Private International Law*

(a) In an international contract, does a limitation or exemption clause remain subject to the law of the contract according to which its validity could not be challenged, when it would be illegal under the *lex fori*? Such a situation could, for instance, occur before a French court in the presence of a clause excluding tort liability, when the contract is subject to Belgian law.[95]

The issue is whether principles governing the validity of limitation and exemption clauses only belong to internal public policy, or can such prin-

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[93] Cf. *supra*, pp. 384–386.

[94] Cf. M. Fontaine, Les clauses exonératoires et les indemnités contractuelles dans les Principes d'Unidroit: Observations critiques, in *Uniform Law Studies in Memory of Malcolm Evans, Int. Uniform Law Rev.* (Rome), 1998, pp. 405–417.

[95] Cf. *supra*, p. 386. On this question, cf. A. Toubiana, *Le domaine de la loi du contrat en droit international privé*, Paris, 1972, pp. 44–46; P. Lagarde, Droit international privé, in *Les clauses limitatives ou exonératoires de responsabilité en Europe*, J. Ghestin, (ed.), Paris, 1990, pp. 17–41; L. Ravillon, *op. cit.*, pp. 246–254.

ciples may, on certain grounds (such as "*ordre public international*" or "directly applicable rules," "*lois de police*," "*lois d'application immediate*"), overrule the more tolerant solutions of the law of the contract.

The matter does not arise when the liability at stake is governed by an international agreement that forbids, in a mandatory way, any deviation from its system, as is often the case in the sector of international carriage.[96] On the other hand, the Vienna Convention on the international sale of goods explicitly does not cover the validity of the contract and of the different clauses (Art. 4a), thus abandoning the fate of limitation and exemption clauses, in principle, to the domestic applicable law.[97]

As regards this applicable law, the well-established principle is that of party autonomy.[98] There is also no challenge that limitation and exclusion clauses are subject to such law of autonomy.[99] Thus, according to Article 10 of the Rome Convention of June 19, 1980, the law of the contract is applicable to ". . . the consequences of breach, including the assessment of damages in so far as it is governed by rules of law."

Accordingly, the validity of a clause limiting or excluding liability will, in principle, be decided according to the law of the contract. This could, however, be different in two situations.

First, the clause at stake could be incompatible with the *ordre public international* of the forum.[100] The French *Cour de Cassation* has avoided a decision, which had not verified whether some clauses, in a contract subject to Belgian law, were in accordance with the French concept of international public policy.[101] When would the *ordre public international* of the forum enter into consideration? One could think of clauses attempting to exclude liability for willful misconduct, or even, in countries that prohibit such agreements, clauses excluding liability for gross negligence,[102] tort liability or personal injury.[103]

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[96] See examples *supra*, pp. 388–389.

[97] Cf. P. Lagarde, *op. cit.*, pp. 20–21; E. Rawach, La validité des clauses exonératoires de responsabilité et la Convention de Vienne sur la vente internationale de marchanduses, *Rev. Int. Dr. Comp.*, 2001, pp. 141–157.

[98] Cf. P. Mayer, *Droit international privé*, Paris, 5th ed., 1994, pp. 454–491.

[99] Cf. P. Lagarde, *op. cit.*, pp. 21–23; Cass. fr., Dec. 5, 1910, *Sir.*, 1911, 1, 129, note Lyon-Caen; Cass. fr., Oct. 4, 1989, *Rev. Crit. Dr. Int. pr.*, 1990, p. 316.

[100] Cf. P. Lagarde, *op. cit.*, pp. 31–35; L. Ravillon, *op. cit.*, pp. 251–254.

[101] Cass. fr., 16 avril 1991, *Bull. Civ.*, IV, No. 147; cf. L. Ravillon, *op. cit.*, pp. 252–253.

[102] Cf. Aix, 27 février 1980, *Gaz. Pal.*, 1982.2.783.

[103] Cf. *supra*, pp. 382–389.

The second situation where the law of the contract might be superseded is when a clause limiting or excluding liability infringes upon "immediately applicable" mandatory rules (*lois de police*).[104] The Rome Convention provides that its rules cannot *restrict the application of the rules of the law of the forum in a situation where they are mandatory irrespective of the law otherwise applicable to the contract* (Article 7 Section 2). This will probably be often the case with consumer protecting regulations.[105]

It has also been argued that clauses limiting or excluding liability would, in principle, be valid in international trade, since the international character of the contract would exclude the application of domestic limits to their validity.[106]

(b) Some statutes take sides on the issue of the validity of limitation and exemption clauses in contracts subject to foreign law. For instance, the English Unfair Contract Terms Act does not apply to a contract, which is subject to foreign law, except when the choice of the law was prompted by the wish to avoid the application of the Act.[107]

B. Consequential and/or Unforeseeable Damages

The problem of consequential or unforeseeable damages is one of the most difficult items to deal with when drafting a clause limiting or excluding liability.[108]

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[104] Cf. P. Lagarde, *op. cit.*, pp. 35–38; L. Ravillon, *op. cit.*, pp. 249–250.

[105] Cf. P. Lagarde, *op. cit.*, pp. 35–38, but this author's opinion is balanced. Comp. L. Ravillon, *op. cit.*, p. 250: ". . . *il ne semble pas que jusqu'à présent les clauses aménageant conventionnellement la responsabilité aient été le terrain d'application des lois de police.*"

[106] Cf. ICC Arbitral award rendered in 1975, published and commented in S. Jarvin & Y. Derains, *ICC Arbitral awards, 1974–1985*, Deventer, 1990, pp. 262–273; B. Audit, *La vente internationale de marchandises*, Paris, 1990, p. 116; compare P. Lagarde, *op. cit.*, pp. 38–40.

[107] Cf. Cheshire Fifoot & Furmston, *op. cit.*, pp. 182–183. The German law on general conditions used to submit the validity of the choice of foreign law, in a contract with a person not engaged in commerce, to the existence of a recognized interest in that choice (Section 10-8 ancien; cf. M. Strauch, *op. cit.*, pp. 497–499). The provision has been repealed.

[108] Cf. H. Dubout, La notion de dommage consécutif ou indirect dans les contrats internationaux, *Cah. jur. et fisc. de l'export.*, 1986, pp. 1249–1264; J. Lookofsky, *Consequential damages in comparative context. From breach of promise to monetary remedy in the American, Scandinavian and international law of contracts and sale*, Copenhague, Jurist Forlag, 1989, 330 pp.; U. Draetta, The notion of consequential damages in the international trade practice, a merger of common law and civil law concepts, *I.B.L.J.*, 1991, pp. 487–498; D. Philippe, A propos du dommage indirect et imprévisible et des clauses s'y rapportant, *I.B.L.J.*, 1995, pp. 171–197.

Non-performance of a contractual obligation normally causes direct and foreseeable damages; at the time of contracting or later, the obligor is in a position to assess the risks he is running if he does not fulfill his obligations. The borrower who, by negligence, loses the borrowed object and cannot return it is fully aware that the obligee's assets will be diminished by the value of the object and that he will be liable for it. But very often, the consequences of a default are more extended, either because consequential damages add up to direct damages (for instance, the lender was going to sell the lost object with a profit), or because the damages—direct or consequential—assume an unforeseen magnitude (the lost object had an exceptional value that the borrower was not aware of).

Examples of consequential or unforeseeable damages have been shown earlier.[109] Reference can also be made to the Norwegian arbitral award rendered in 1978 in the *Wingull* case.[110] The defective performance of a ship apparatus worth 300,000 Norwegian crowns had eventually caused indirect damages of 16 million crowns!

The status of consequential or unforeseeable damages must be considered with special care when drafting clauses limiting or excluding liability.[111] But references to consequential or unforeseeable damages are not always drafted with the necessary skill. They sometimes neglect the specificities of the law applicable to the contract, and often they are missing altogether in limitation clauses. We would like to insist on the importance of this issue with the following general observations:

How extensive is the obligation to compensate for loss? The liable obligor must certainly indemnify direct and foreseeable damages. But what about consequential damages? Unforeseeable damages? In most legal systems, limits are set to the extent of the damages for which the obligor at fault is liable. But not all solutions are alike. Before drafting a provision, it is indispensible to research the legal system intended to be modified.

The position of French and Belgian law on this point is expressed in Articles 1150 and 1151 of the Civil Code. Both texts limit the liability of the obligor in case of consequential and unforeseeable damages. Case law, however, is often more favorable to the aggrieved party.[112] In common law, the famous *Hadley v. Baxendale*[113] case applies principles that are similar to

[109] Cf. *supra*, pp. 373–378.

[110] Cf. L. Arentz-Hanssen, *op. cit.*, pp. 509–511.

[111] Cf. *supra*, pp. 373–378.

[112] Cf. F. Terré, Ph. Simler & Y. Lequette, *op. cit.*, pp. 538–540, 579.

[113] 9 Ex. 341, 156 Eng. Rep. 145 (1854).

those of French law.[114] But in German and Scandinavian law, the doctrine of *adequate causation* (all prejudice deriving in an adequate manner from the contractual breach must be indemnified) leads to a greater liability for indirect damages.[115]

Article 74 of the Vienna Convention on the international sale of goods adopts a similar position:

> "Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract."

The Unidroit Principles on international commercial contracts entitle the aggrieved party to *full compensation for harm sustained as a result of the non-performance,* including *any loss which it suffered and any gain of which it was deprived* (Article 7.4.2.). However:

> "The non-performing party is liable only for harm which it foresaw or could reasonably have foreseen at the time of the conclusion of the contract as being likely to result from its non-performance" [art. 7.4.4].

The Principles of European contracts law have similar provisions, with the exception that they discard the exclusion of non-foreseeable damages when the breach was intentional or grossly negligent (Articles 9.502 and 9.503).

These various solutions are seldom mandatory and the validity of clauses excluding or limiting liability for consequential and/or unforeseeable damages is not threatened by specific causes of invalidity other than those that may affect limitation and exemption clauses in general (willful misconduct, gross negligence, unreasonableness, etc.).

There is an exception in Section 2-712 (1) of the American UCC, stating that "consequential damages may be limited or excluded unless the lim-

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[114] The inspiration was deliberate, according to R. Danzig, Hadley V. Baxendale: A Study in the Industrialization of the Law, *Journ. of Legal Studies,* 1975, p. 257. On more recent interpretations, cf. M. Elland-Goldsmith, Les principes généraux du droit anglais des contrats et les opérations internationales, *D.P.C.I.,* 1980, pp. 465–466.

[115] Cf. J. Hellner, Consequential Loss and Exemption Clauses, *Oxford J. of Legal Studies,* 1981, p. 14; Palandt, *op. cit.,* p. 265.

itation or exclusion is unconscionable."[116] It will also be recalled that many legal systems forbid the application of clauses limiting liability to compensation for personal injuries,[117] which, in contractual matters, are often indirect damages.[118]

Drafters of clauses limiting or excluding liability are thus advised to be extremely careful when it comes to consequential and/or unforeseeable damages. Considerable interests may be at stake, and there are significant differences between the solutions given by the various domestic legal systems and court interpretations,

In the above analysis,[119] various examples of possible wording have been given. One shall take care to use the terminology adapted to the law applicable to the contract, and to take into account the mandatory rules this law may contain. When different types of excluded damages are listed, each item has to be considered in light of the possible consequences, in the case of non-performance, and the obligor's interest in keeping such a list specific.

C. Limitation Clauses and Insurance

Insurance often has an impact on exemption or limitation of liability clauses, either by influencing the contractual wording or by affecting the validity of clauses.

1. *Influence on Contractual Practice*

It is well known that close links exist between liability and insurance. This correlation is apparent in the area of exemption or limitation of liability clauses, where the insurability of the risks concerned is at the origin of some interesting techniques. Here are a few illustrations:

a. The Obligee Is Insured

The fact that the obligee takes out property insurance may result in an exemption of liability for the obligor and in a reduction of the contractual price. The following example is taken from a contract for maintenance and supply of spare parts:

> "The parties have agreed that it is more practicable for the Customer to effect insurance in respect of any loss or damage of

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[116] Cf. B. Hanotiau, *op. cit.*, p. 517.

[117] Cf. *supra*, p. 386.

[118] But not always: cf. contracts for carriage of persons or medical care.

[119] Cf. *supra*, pp. 373–378.

> any kind which may arise out of or in connection with the performance of the Services under this Agreement, and the Fee has been reduced accordingly. It is therefore agreed that the Company will not be liable in any circumstances whatsoever for loss or damage of any kind suffered by the Customer or by any third party howsoever caused unless the same shall relate to personal injury or death and only then if the same shall arise out of the Company's negligence. Save as aforesaid the Company shall be under no liability whatsoever under or in connection with this Agreement whether performance or manufacture be by itself or of any other persons and any condition or warranty which might otherwise be implied or incorporated by the contract or by reason of Statute or Common Law is hereby excluded."

Besides a reduction in the price, the obligee may also prefer the security afforded by an insurance company against the uncertainty in case of an action in liability. This has reportedly been the position of some oil companies towards builders of oil rigs.

Such a waiver of claim on the obligee's part, however, constitutes for the insurer an important element in assessing the risk, since it makes subrogatory claims impossible. Consequently, the insured should declare such waiver to the insurer, in order to avoid the consequences provided by insurance law in case of non-disclosure.[120]

The following clause concerns this issue:

> "Sans préjudice des dispositions contraires du présent contrat, X et Y renoncent réciproquement à tout recours qu'ils pourraient exercer l'un contre l'autre, sur une base tant contractuelle que délictuelle, pour tout dommage subi par ou à l'occasion de ce contrat.
>
> "Les parties s'engagent à porter cette renonciation à la connaissance de leurs assureurs.
>
> "En conséquence, les polices d'assurance de chaque partie devront prévoir que l'assureur renonce à tout recours contre l'autre partie."

It has been noticed that the exemption from liability is reciprocal.

One should also see that the insurance actually covers all the damages from which the supplier is exempted (e.g., indirect damages). If this is not the case, clauses like the following one are used.

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[120] Cf. *supra*, pp. 353–354.

So-called "benefit of insurance" clauses are sometimes declared void (cf. *infra*, p. 399).

In a car sales contract, the insurance taken out by the buyer only exonerates the seller within the limits of the coverage it provides; over and above these limits, the seller is liable again:

> "En cas de dommage causé par une négligence légère, le vendeur voit sa responsabilité engagée pour autant que le dommage dépasse les prestations des assurances sociales, d'une assurance accidents ou d'une assurance dégâts matériels et que le dommage aux tiers ne soit pas couvert par l'assurance automobile obligatoire."

b. The Obligor Is Insured

If the obligor is insured against liability, limitation clauses may appear less useful. They still are useful, however, when the insurance coverage is limited, as it frequently is. The obligor shall then take care to adjust the extent of his liability to the coverage provided by the insurance. It sometimes works the other way around: the existence of a limitation clause will enable the obligor to obtain a cheaper insurance policy.

Here is an example of a clause limiting liability to the amount that the obligor can recover from other sources, especially from the insurance.

> "CONTRACTOR shall not be liable for any loss sustained by OWNER of its anticipated profits from operation of PLANT or other consequential damages except to the extent CONTRACTOR may recover such losses from insurances carried by CONTRACTOR pursuant to the CONTRACT, vendors, subcontractors, renters of construction tools and equipment. CONTRACTOR shall exert all reasonable efforts and diligence to recover such losses from such parties. In case such parties have to be sued CONTRACTOR has first to reach agreement with OWNER; cost of action are on OWNER's account."

The situation changes when the obligor waives the limitation of his liability if the customer (obligee) accepts to bear the cost of the liability insurance. See the following example, where a consulting firm limits its liability to the amount of its fees:

> "S'il est reconnu, au bénéfice du client, un droit à réparation du préjudice direct subi, le montant de l'indemnité correspondante ne pourra excéder un maximum fixé au contrat. Quoi qu'il en soit, la responsabilité du bureau d'études techniques est toujours proportionnée au montant de ses honoraires relatifs à l'ouvrage incriminé et les dommages-intérêts qui peuvent lui être réclamés ne peuvent, en aucun cas, dépasser ce montant. Dans le cas où le

client exigerait une couverture des responsabilités dépassant cette limite, une assurance spéciale sera prise par le bureau d'études techniques aux frais du client."

In this example, it is the liability towards third parties which is covered by insurance, the cost of which is borne by the customer, covering, as well, damages to the equipment to be used by the consulting engineer and purchased at the client's expenses:

"Sauf avis contraire exprimé par écrit par le client, l'ingénieur-conseil devra, aux frais du client, prendre et renouveler pour un temps et dans des conditions ayant l'approbation du client, une assurance adéquate de responsabilité civile contre la perte ou les dommages subis par les équipements acquis, au moyen de fonds fournis par le client, pour le seul usage de l'ingénieur-conseil, dans le cadre de l'exécution des Services, sous réserve que l'ingénieur-conseil fasse de son mieux pour souscrire à ses frais une assurance couvrant raisonnablement ses risques professionnels."

Here, insuring liability towards third parties is imposed upon the consultant, but the cost is not directly borne by the client:

"The Consultant shall take out and/or maintain adequate Insurance against third party liabilities in accordance with good recognized practice of reputable international professional engineers and consultants."

This clause is linked to a hold-harmless undertaking by the consultant benefiting the client, in case of third-party claims.

The limitation of liability stipulated in the contract is sometimes applicable only over and above what the seller can himself recover from various sources, especially from his insurance contracts.

"The limit of cumulative liability under paragraph B shall be over and above contractors's own services to be performed pursuant to above paragraph B-a plus any indemnification recovered from vendors, subcontractors (contracted in name and on behalf of), and insurances carried by CONTRACTOR pursuant to the CONTRACT."

c. The Exemption Clause Renders Insurance Unnecessary

Some contracts signed by the American government—especially concerning defense—contain limitation of liability clauses favorable to the contractor, because the government intends to remain its own insurer and

does not wish the price of the contract to be increased by the cost of a liability insurance. Here is an example:[121]

> "a) Except for remedies expressly provided elsewhere in this contract, the Contractor shall not be liable for loss of or damage to property of the Government (excluding the supplies delivered under this contract) occurring after acceptance of the supplies delivered under this contract and resulting from any defects or deficiencies in such supplies.
> "b) The foregoing limitations shall not apply when the defects or deficiencies in such supplies or the Government acceptance of such supplies resulted from willful misconduct or lack of good faith on the part of any of the Contractor's directors or officers, or on the part of any of his managers, superintendents, supervision or direction of:
> - "(i) all or substantially all of the Contractor's business; or
> - "(ii) all or substantially all of the Contractor's operations at any one plant or separate location, in which this contract is being performed; or
>
> "c) Notwithstanding paragraph (a) above, if the Contractor carries insurance or has established a reserve for self-insurance covering liability for damages or losses suffered by the Government through purchase or use of the contract supplies required to be delivered to the Government under this contract, the Contractor shall be liable to the Government to the extent of such insurance or reserve for self-insurance for damages or losses to property of the Government occurring after acceptance of the supplies delivered to the Government under this contract and resulting from any defects or deficiencies in such supplies."

The wish to avoid insurance costs is revealed in some contracts signed by NASA concerning the use of the space shuttle: in this case, it is the possible liability of the contractor towards third parties that is covered by NASA, this time in the form of a *hold-harmless* agreement.[122]

2. Insurance and the Validity of Exemption Clauses

Does the fact that a risk can be insured (property insurance by the obligee, liability insurance by the obligor) affect the validity of a limitation or exemption clause?[123] Can the validity of such a clause be justified by the fact that the risk was uninsurable by the obligor, or insurable by the obligee?

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[121] This example comes from P.J. Thys & M.H. Golub, *op. cit.*, p. 526.

[122] *Id.*, pp. 526–527, where the full text of this provision is quoted.

[123] On this issue, see the remarkable comments by J. Hellner, *op. cit.*, pp. 44–48.

In England, the Unfair Contract Terms Act, Section 11(4)(b), states that the reasonableness of a limitation clause can be inferred from the fact that the obligor has difficulties finding insurance.[124] The fact that a liability may be uninsurable can thus contribute to justifying the validity of an exemption or limitation clause.

On the other hand, some liability systems take very precise positions concerning the allocation of the risks among the contracting parties, and their solutions are imperative. This is the case with some international transport agreements, such as the CMR. which provides that "a benefit of insurance in favor of the carrier . . . shall be null and void" (Article 41, 2°).[125] Consequently, the carrier cannot exempt itself from its liability on the grounds that the other party has insured the goods. Such a transfer of benefit of insurance would indeed modify the mandatory liability system.[126]

IV. CONCLUSIONS

Clauses excluding and limiting liability and warranty have certainly provided the Working Group with one of its richest themes, and the above chapter did not nearly exhaust the subject.

Liability, being one of the risks of contracting, must be considered when negotiating the allocation of such risks. Depending on the respective power of the parties, and on the contractual price, the harmful consequences of non-performance will be shared in various ways between the obligor in breach and the aggrieved obligee.

Exemption and limitation clauses are not, however, the only elements regulating this allocation of risks. The law applicable to the contract had already achieved some allocation (e.g., by preventing the obligee from recovering indirect damages). Other clauses can also have an important impact on this problem, such as *force majeure* or liquidated damage clauses.

Drafting techniques of limitation and exemption clauses may vary greatly, as the above analysis demonstrates. Thus, special attention should be paid to the problem of the validity of these clauses under the law applicable to the contract. Liability systems are closely linked to moral values, and legal solutions are often mandatory.

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124 Cf. Cheshire Fifoot & Furmston, *op. cit.*, p. 196.

The clause quoted *supra*, pp. seems to have been inspired by this provision of the U.C.T.A.

125 Cf. *supra*, pp. 388–389. For an example of such a clause, cf. *supra*, pp. 394–395.

126 Cf. *supra*, pp. 388–389.

CHAPTER 8

FORCE MAJEURE CLAUSES IN INTERNATIONAL CONTRACTS

I. INTRODUCTION

Obstacles outside the control of the parties may appear in the course of performing international contracts. The goods to be delivered are destroyed by fire or lost in a shipwreck. An armed conflict prevents the construction to continue. The export license is withdrawn by administrative measures.

Under such circumstances, is the obligor liable, or may he claim a cause of exoneration? What is to happen to its obligation? What happens to the other party's performance? What happens to the contract as a whole?

Each legal system takes a stand on these different questions, and the answers are not identical. But practitioners engaged in international trade generally prefer to organize the consequences of such events themselves, through contractual provisions called *force majeure clauses.*

The concept of *force majeure* comes from Roman law, and it remains a classical notion in certain romanistic legal systems such as French law. However, *force majeure* clauses offer very original characteristics in the practice of international contracts. In relation to both the concept of *force majeure* and the accommodation of its effects on contractual obligations, drafters of clauses have often been innovative in comparison to the solutions traditionally taught by romanistic lawyers. The study of these developments stemming from practice is of great importance for the purposes of refining legal theory. For practitioners, moreover, a critical analysis of the clauses collected for these discussions highlights the different aspects of *force majeure* clauses that must be attentively considered during negotiations, with all their possible variations and the drafting traps to avoid.

Collecting a sample of *force majeure* clauses is not difficult; these clauses are common. The Working Group gathered over 150, among which 40 or so, selected beforehand on the basis of their interesting characteristics, were discussed in great detail.

Force majeure clauses can be drafted in a few lines. In complex contracts, on the other hand, they may become quite elaborate. One clause analyzed

by the Group covered 27 pages! When comparing recent clauses with earlier ones, the tendency is definitely towards more drafting sophistication.

An analytical description of the *force majeure* clauses collected (Section II) will be followed by some critical considerations (Section III).[1]

II. PRACTICE

The following analysis is an attempt to draw up a picture of the principal elements generally present in *force majeure* clauses, with the numerous variations, some of them better than others.

Like most contractual clauses, the *force majeure* clause consists of two parts: first the *hypothesis* on which it rests is defined (Section II.A); the clause then describes the applicable *regime* (Section II.B).

A. Hypothesis

The hypothesis considered here is the *force majeure* event. However, that concept, arising from Roman law, is not found in all legal systems, and where it is accepted, it is inevitably interpreted in diverse ways. That is why, even when the concept of *force majeure* is recognized under the law of the contract, drafters of clauses often feel the need to define it, or even to include in the definition a series of examples of this type of event. In many cases, they are attempting to characterize, contractually, a contingency that diverges, to a greater or lesser extent, from the criteria employed by the applicable law, either by broadening the definition, or by including in the list events that would not necessarily be categorized as *force majeure*. The

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[1] *Force majeure* clauses in international contracts have been the subject of several other studies. Cf. Ph. Kahn, Force majeure et contrats internationaux de longue durée, *Journ. Dr. Int.*, 1975, pp. 476–477; D. Lamethe, La clause de force majeure dans les contrats internationaux, C.J.E.G., January 1987, pp. 467–475; U. Draetta, R.B. Lake & V.P. Nanda, *Breach and Adaptation of International Contracts*, Salem, 1992, pp. 85–99; P. Moisan, Technique contractuelle et gestion des risques dans les contrats internationaux: les cas de force majeure et d'imprévision, 35 *Les Cahiers de Droit*, 1994, pp. 281–334; M. Furmston, Drafting of force majeure clauses—some general guidelines, in *Force majeure and Frustration of Contract*, E. McKendrick (ed.), L.L.P., 1995, pp. 57–62; A. Berg, The detailed drafting of a force majeure clause, *id.*, pp. 63–120; U. Draetta, Force majeure clauses in international trade practice, *Rev. Dr. Aff. Int.*, 1996, pp. 547–559; M. Marmursztejn, Les clauses de force majeure dans les contrats de l'amont d'une société pétrolière: une étude de cas, *I.B.L.J.*, 1998, pp. 781–806; J.M. Mousseron, *Technique contractuelle*, Paris, 2nd ed., 1999, No. 1390–1394; Chr. R. Seppala, FIDIC's New Standard Forms of Contract: Risks, Force Majeure and Termination, *I.B.L.J.*, 2000, pp. 1013–1025; U. Draetta, Les clauses de force majeure et de hardship dans les contrats internationaux, *Dir. del Comm. Int.*, 2001, pp. 297–308, *I.B.L.J.*, 2002, pp. 347–358; H. Konarski, Force Majeure and Hardship Clauses in International Contractual Practice, *I.B.L.J.*, 2003, pp. 405–428.

variety of formulae is boundless; furthermore, the wording is often defective. Below we will attempt to describe the most interesting or the most representative examples from our collection.

1. Definitions

a. Classical Definitions

Classical definitions of *force majeure* appear in the following the clauses:

- "Force majeure are contingencies caused by neither of the parties and which are unforeseeable at the time of concluding the Contract, uncontrollable and which render the further performance of the contractual obligations impossible . . ."
- "On entend par force majeure tous les évenements indépendants de la volonté des parties, imprévisibles et inévitables, intervenus après l'entrée en vigueur du contrat et qui empêchent l'exécution intégrale ou partielle des obligations dérivant de ce contrat."

Those two examples highlight the traditional criteria for *force majeure*, namely, unforeseeability, unavoidability, the fact that events are outside the control of the parties and the effect of rendering performance of the obligation impossible.

b. Attenuation of Criteria

In general, however, clauses, which contain a definition of *force majeure*, fail to include one or another of these criteria, or express them in a less rigorous manner.

Unforeseeability, for example, is not expressly required in the following clauses:

- "In the Contract "force majeure" shall mean any occurrence outside the control of the parties preventing or delaying their performance of the contract. . . ."
- "En cas de survenance d'événements indépendants de la volonté des parties et d'impossibilité d'exécution totale ou partielle par une des parties engagées par la présente convention. . . ."
- ". . . in case of force majeure or for any reason beyond its control making it impossible for producer to manufacture or to deliver. . . ."

Unavoidability is rarely omitted. Here, however, is such an example:

"The contracting parties are relieved of their obligations for partial or complete failure to comply with the contract liabilities with regard to the delivery terms if such failure is due to force majeure.

Force majeure regards all circumstances occurred after the signature of the contract and as a result of any event of exceptional nature that could not have been anticipated by the contracting parties at the signature of the contract. . . ."

Also, exceptionally, drafters forget to refer to the effect that the event must have on performance of the contract:

"On entend par force majeure pour l'exécution du contrat tous les événements indépendants de la volonté des parties, imprévisibles ou, si prévisibles, inévitables."

Such omissions may be inadvertent; some of them perhaps reflect the desire to relax the classic conditions of *force majeure.* However, that desire is more obvious in clauses that expressly set out the traditional criteria together with qualifications intended to temper their stringency.

Unavoidability is relaxed in the following clause:

"On entend par force majeure pour l'exécution du contrat tout acte ou événement imprévisible, irrésistible, hors du contrôle des parties et qui ne pourra être empeché par ces dernières malgré des efforts *raisonnablement possibles.*"

In other examples, reasonableness also extends to unforeseeability:

- ". . . tout événement, circonstance ou état de fait que le vendeur ne pouvait raisonnablement ni prévoir, ni empêcher et auquel il lui a été impossible de porter remède de manière à pouvoir respecter les délais contractuels de livraison."
- "Une partie n'est pas tenue pour responsable de la non-exécution de l'une quelconque de ses obligations dans la mesure où elle prouve:
- "que cette non-exécution a été due à un empêchement indépendant de sa volonté;
- ". . . qu'elle ne pouvait pas raisonnablement être tenue de prévoir cet empêchement et ses effets sur son aptitude à exécuter le contrat au moment de sa conclusion;
- "et qu'elle n'aurait pas pu raisonnablement éviter ou surmonter cet empêchement, ou à tout le moins, ses effets."[2]

[2] Clause taken from the ICC Model Franchising Contract, Paris, ICC, 2000.

One clause refers to due diligence, possibly also allowing a more flexible interpretation of the criteria in question:[3]

> "By force majeure are to be meant extraordinary events independent of the Parties' will that cannot be foreseen or averted by them even with due diligence, being beyond their control and preventing the Contracting Party / or Parties / to come up to his (their) obligation(s) undertaken in this Contract."

One criterion very commonly used to assess *force majeure* is to be found in the expression *beyond the control of the parties.* Several of the clauses just cited include that expression, or a similar expression. It may be that this criterion comes under the classic conditions for unavoidability, or for an event that is outside the will of the parties. Some consider nonetheless that the expression reflects the desire to relax the traditional requirements, if only by means of reference to the parties themselves (assessment *in concreto*). That desire is clear when the expression also refers to the term "reasonable": *beyond the reasonable control of the parties.*[4]

The attenuation of the requirements, however, usually refers to the impact of *force majeure* events on the performance of contractual obligations. It is not always required that performance be absolutely impossible:

- "On entend par force majeure . . . tout acte ou événement imprévisible, irrésistible et indépendant de la volonté des parties rendant momentanément *humainement* impossible l'exécution de leurs obligations ou de certaines d'entre elles."
- "Sont considérés comme cas de force majeure ou assimilés, outre les cas communément admis par la jurisprudence belge et française . . . [this is followed by a list of events]
  ". . . et en général, toutes les causes étrangères à la volonté ou à l'influence des contractants qui pourraient mettre obstacle à la marche normale de l'approvisionnement, de la fabrication ou des expéditions des contractants."
- "If either party is prevented from or delayed in carrying out any of the provisions of this Agreement by reason of . . . [enumeration of events]
  ". . . or any cause beyond its control making it impossible or *exorbitant from an industrial or commercial standpoint* to perform its obligations hereunder. . . ."
- "Force Majeure means any event beyond the reasonable control of and without the fault or negligence of the party affected . . . which

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[3] On the concept of "due diligence," cf. *supra*, Chapter 4.

[4] Cf. *supra*, Chapter 4, pp. 214–217.

materially and adversely affects the performance by a Party of any obligation hereunder, provided however. . . ."

It should be noted that the latter clause differs in two respects from classic *force majeure:* it attenuates the requirement of impossibility of performance and leaves out the criterion of unforeseeability.

In other examples, unforeseeability is also left out, but it is the unavoidability that is less rigorously assessed here:

- "If either Sellers or Buyers are rendered unable wholly or in part by force majeure to carry out their obligations under this Agreement. . . ." [this is followed by the applicable regime].
- "The expression 'force majeure' shall mean circumstances which were beyond the control of the party concerned *exercising the standard of care of a reasonable and prudent operator.*"
- "The expression 'force majeure' shall mean circumstances . . . which were beyond the control of the party concerned and which by the *exercise of due diligence and reasonable foresight* it could not have prevented or overcome."

c. Reference to External Criteria

Sometimes, drafters of clauses do not include an original definition, but refer to sources of interpretation which are external to the contract.

- "The Sellers shall not be held responsible for late delivery or non-delivery of the goods *owing to generally recognized 'force majeure' causes.*"
- "Outre *les cas de force majeure admis par la jurisprudence,* sont notamment considérés comme causes d'exonération s'ils interviennent après la conclusion du contrat et en empêchent l'exécution: . . . [this is followed by an enumeration]
  ". . . lorsque ces autres circonstances sont indépendantes de la volonté des parties."

The Working Group drew particular attention to the dangerously vague nature of those formulations, in particular in the first of the two clauses. Although the law of the contract probably limits the discussion, one may well wonder by whom these causes of *force majeure* should be recognized. By the law? By the case law? By academics? Or did the parties intend to refer to the *lex mercatoria?* The second clause is a little less imprecise, in that it refers expressly to the case law, and that certain criteria for interpretation are provided in relation to the events listed after the general formula; however this is still a far cry from model drafting.

There is a similarity between the second clause and the one already cited earlier which referred to *cas communément admis par la jurisprudence belge et française.*

The sample we looked at included two clauses which relied on the parties themselves, or on arbitrators, to decide whether an event was one of *force majeure:*

- "If either of the parties be prevented from performing its obligations under the contract by such cases of force majeure as . . . [this is followed by an enumeration of events]
  ". . . or by other *causes which can be recognized by both parties* as being cases of force majeure for being beyond their control. . . ."
- "les cas de forc majeure sont . . . [this is followed by an enumeration of events]
  ". . . ainsi que les *autres cas à déterminer par l'arbitrage* comme cas de force majeure."

These formulations also appear very dangerous by reason of their lack of precision; they tend to be ambiguous. Unlike the first, the second clause does not even provide a single criterion for assessment.

The following clause, however, is interesting as it borrows in precise terms its concept of *force majeure* from a national law:

> "'Unabwendbare Gewalt' is a circumstance preventing the fulfilment of contractual obligations which at the time of conclusion of this Agreement, was unforeseeable and could not be prevented with the diligence commonly required in international trade (*as set forth in Article 293, paragraph 1 of the 'Gesetz über internationale Wirtschaftsverträge' of February 5, 1976,* as published in the *Gesetzblatt der DDR,* dated February, 10 1976)."

Though this law is no longer in force since the reunification of Germany, the model remains of interest. From the information available, the remainder of the contract was probably not subject to East German law (there was no express clause relating to the applicable law). Members of the Group however pointed out the dangers of *dépeçage.* The grafting of a domestic regime governing *force majeure* onto a contract governed by a different legal system may cause problems of incompatibility. Insoluble difficulties may arise if the liability regime is subject to one legal system and that governing clauses excusing performance is subject to another.

d. Lack of Definition

Other clauses, finally, do not provide any direct or indirect criterion for the determination of the meaning to be given to the words "*force majeure.*" The expression is used as such, with no further information:

- "S'il se produit des circonstances ou des événements de force majeure et/ou de cas fortuit . . ." [this is followed by a description of the consequences].
- "Tous les cas de force majeure, qui peuvent se présenter pendant la durée du contrat, déchargent la partie etc."
- "Au cas où le fournisseur prévoierait, pour cas de force majeure, une diminution de ses fournitures. . . ."

The only option available to the person who is to interpret the contract is then to refer to the law of the contract. However, this supposes that that law recognizes the concept of *force majeure.*

Sometimes, the absence of a definition is partially alleviated by having a list giving examples of cases of *force majeure*:

- "En cas de force majeure (incendie, inondation, tremblement de terre, épidémie et autres calamités). . . ."
- "Par cas de force majeure s'entendent les cas comme guerre, incendie, explosion et fléaux de la nature tels que: inondation, tremblement de terre, etc."

Those two clauses appear to refer only to events of a catastrophic nature, which can give an indication to the person interpreting the contract. But they do not reveal anything as regards the characteristics that those events must have in order to constitute *force majeure* in the particular case (unforeseeability, unavoidability, etc.).

2. Enumerations

We have just seen two examples of lists of circumstances that constitute *force majeure,* in instances where those lists took the place of absent definitions. In general, however, a list, which was present in two-thirds of the cases in our sample, serves to illustrate the definition. We shall first try to draw up an overview of the circumstances most frequently found in the lists considered by the Working Group, before examining the possible relationship between definitions and lists.

a. Lists

(a) *Natural disasters* are the most frequently cited. It is rare to find a list that does not cite at least one or the other of them. Here, are several examples taken from *force majeure* clauses:

- "... tremblement de terre, typhon, tempête, alluvions, incendies...."
- "... incendie, inondation, sécheresse, glace...."
- "... force of nature, perils of navigation, shipwreck, ..., ... epidemics, ... landslides, lightning, earthquakes, fires, storms, tidal waves, floods, washouts, ... freezing of lines...."

The list sometimes ends with a general formula:

- "... earthquake, flood, fire or other natural disaster."
- "... incendie, inondation, tremblement de terre, épidémie et autres calamités...."

The general formula may also come first:

"... les calamités naturelles ou les autres événements tels que: tremblement de terre, typhon, tempête, inondations, alluvions, incendies, etc."

Other clauses simply use a general formula to cover natural disasters:

- "... any operation of the forces of nature...."
- "cataclysmes...."

The English expression *Act of God* is often used for the same purpose; in contracts formerly concluded with socialist countries, the expression "*Act of Elements*" was sometimes used instead.

(b) *Armed conflicts* make up the second category of events most frequently found in lists. Here also, clauses differ according to whether or not they use general formulae, and according to whether or not they attempt to cover the greatest number of possible cases:

- "Disasters, such as ... war."
- "... opérations militaires de tous genres...."
- "... acts of war, ... revolutions and the like."
- "... la guerre (declarée ou non), la rébellion, la révolution, la commotion civile...."
- "... war, preparation for war, blockade, revolution, insurrection, mobilisation, civil commotions, riots...."
- "... war, hostilities (whether war be declared or not), invasion, act of foreign enemies, rebellion, revolution, insurrection or military or usurped power, civil war, or (otherwise than among the Contractor's own employees) riots, commotion or disorder...."

(c) *Industrial disputes* do not feature in all lists.[5] When such disputes are accepted as possible instances of *force majeure*, they are often referred to in

[5] Considering industrial disputes as *force majeure* cases used to be an important source of controversy in East-West trade.

rather vague terms, by including the words *grève, strike,* or alternatively *lock-out* or *go-slow* in the list. However, here are some more explicit turns of phrase which were found in the sample examined by the Working Group:

- ". . . strike or lockout or other industrial action. . . ."
- "la grève, . . . les troubles du travail. . . ."
- ". . . strike, lockout, differences with workmen. . . ."

Certain clauses cover industrial disputes within the enterprise itself, or even within its sub-contractors:

- ". . . labor trouble from whatever cause arising and whether or not the demands of the employees involved are reasonable and within said party's power to concede. . . ."
- "grèves générales, grèves organisées syndicalement dans l'entreprise du vendeur et dans les entreprises de ses sous-traitants. . . ."

The last example appears to exclude so-called wildcat strikes.

In other instances, on the contrary, the clause restricts the notion of *force majeure* to industrial disputes outside the firm:

- ". . . national, regional, city-wide or industry-wide strikes. . . ."
- ". . . strikes, works to rule or go-slows that extend beyond the Complex, are widespread or nationwide, or that are of a political nature, such as, by way of example and not limitation, labour actions associated with or directed against a Country political party, or those that are directed against the Company (or its Contractors) as part of a broader pattern of labour actions against companies or facilities with foreign ownership or management. . . ."
- "Labour disputes involving Company's personnel and or engineer's personnel shall not be considered as force majeure. Only other (external) strikes affecting directly the ability of the party(ies) to perform its (their) obligations under this Agreement shall be accepted as force majeure."

None of the clauses considered included any reference to some of the forms of industrial dispute which have developed in recent years, such as the occupation of factories.

(d) Among the events most frequently found in lists of instances of *force majeure* are the *breakdown of machinery and similar accidents:*

- ". . . bris ou mise hors service de machines. . . ."
- ". . . accident to plant. . . ."

- ". . . explosions, breakage or accident to machinery, oil or gas pipelines. . . ."
- ". . . les accidents d'exploitation généralement quelconques. . . ."

(e) *Transport difficulties and/or procurement difficulties* also pre-occupy the drafters of many clauses:

- ". . . impossibility of the use of railway, port, airport, river transport, roads. . . ."
- ". . . manque de wagons ou tonnage. . . ."
- ". . . delays of carriers. . . ."
- ". . . interruption or delay of transport facilities. . . ."
- ". . . grave crises de ravitaillement ou matières premières indispensables à la production. . . ."
- ". . . complete or partial shutdown of plant by reason of inability to obtain sufficient raw materials or power. . . ."
- ". . . shortage of labour, . . . power or fuel shortage. . . ."
- ". . . lack or failure of supplies of power, raw materials and labour. . . ."
- ". . . disturbance in supplies from normally reliable sources. . . ."

(f) *Fait du prince,* that is to say an obstacle to performance of contractual obligations resulting from the intervention of public authorities, may take different forms:

- ". . . interdiction d'exportation ou importation. . . ."
- ". . . inability to obtain necessary construction or exploitation permits. . . ."
- ". . . interdiction de transfert de devises, . . . restrictions d'emploi d'énergie. . . ."

It may be deemed preferable to use more general expressions:

- ". . . governmental order or regulation. . . ."
- ". . . acts of Government or any governmental authority or representative thereof (whether or not legally valid). . . ."
- ". . . any legislative, judicial or governmental action. . . ."

The special case of *change of legislation* is more and more often considered in recent contracts. Very elaborate clauses can cover situations when such modification of the law would render performance impossible—or more onerous.

Here is an example:

"A 'Change in Law' means:

"(a) the adoption, promulgation, modification, repeal or re-interpretation after the effective Date by any Governmental Entity of any Law of (*country*), including, without limitation, a decision of a Governmental Entity after the Effective Date, which (or the effects of which) amends or conflicts with the Laws of (*country*) established or in effect as of the Effective Date, or

"(b) the imposition after the Effective Date by a Governmental Entity of any term or condition in connection with the issuance, renewal, extension, replacement or modification of any Consent,

"that in either case contributes to a Change in Costs, requires a Statutory Modification, renders the Financing Documents unlawful, unenforcable, invalid or void or establishes requirements for, or imposes restrictions on the construction, operation, maintenance, financing, insurance or ownership of the Complex or the Company, or the prices payable under the Agreement, that are more restrictive or more onerous than the most restrictive or most onerous requirements (i) in effect as of the Effective Date, (ii) specified in any applications, or other documents filed in connection with such applications, for any Consent filed by the Company on or before the Commercial Operations Date, so long as such requirements are consistent with the Laws of (*country*) in effect as of the Effective Date or (iii) agreed to by the Company in any agreement in the Security Package."

Such provisions are to be compared to the so-called stabilization clauses, through which parties agree that the law applicable to the contract will be that of a certain country, as it stood when the contract was executed. This attempt to freeze a legal system by neutralizing its later developments can raise several problems, especially if one of the contracting parties is part of the state authority involved.[6] It may be more efficient to cope with the problem of legislative change in the *force majeure* clause and to organize the effects of the event on the contract. The benefit of such a clause cannot, of course, be extended to the contracting State.[7]

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[6] On these clauses, cf., Ph. Weil, Les clauses de stabilisation ou d'intangibilité insérées dans les accords de développement économique, Mélanges Ch. Rousseau, 1974, pp. 301–328; N. David, Les clauses de stabilité dans les contrats pétroliers. Questions d'un praticien, *Journ. Dr. Int.*, 1988, pp. 79–107; S.H. Chatterjee, The Stabilisation Clause Myth in Investment Agreements, *Journ. of Int. Arb.*, 1988, pp. 97–112; W. Peter, Les clauses de stabilisation dans les contrats d'Etat, *I.B.L.J.*, 1998, pp. 875–891.Cf. also ICC award No. 3380, rendered on November 29, 1980, in S. Jarvin & Y. Derains, *Recueil des sentences arbitrales de la C.C.I.*, 1975–1985, Kluwer, 1990, pp. 96–100.

[7] On the combination of those two clauses when they coexist, see M. Marmursztejn, *op. cit.*, pp. 787–789.

The following clause contains a more general reference to *material adverse governmental action:*

> "For purposes of this Clause 18.4 and Clauses 18.1.2 and 23.4.2, a material adverse governmental action shall occur if
>
> "(i) the Government or any Relevant Authority takes action of any nature whatsoever, including the introduction or application of any law, decree or regulation, whether prior to or after the Date of the Concession Contract, or fails to carry out its obligations as prescribed by law, the principal effect of which is directly or indirectly borne by the Concession Company or by the Concession Company and other toll road concessionaires and only incidentally by other Persons or
>
> "(ii) the Government or any Relevant Authority takes or omits to take any action of any nature whatsoever, which, if such action had been taken or omitted by the Ministry, would have constituted a material breach of the Concession Contract by the Ministry (it being understood that an increase in taxes of general application which does not discriminate against the Concession Company or the Concession Company and other toll concessionaires, shall not be deemed a material breach of Clause 7.1.1 of the Concession Contract) and, in the case of either sub-clause (i) or sub-clause (ii), such action, failure or omission, as the case may be, materially adversely affects the economic position of the Concession Company, except under circumstances where such action or omission is in response to any act or omission on the part of the Concession Company which is illegal (other than an act or omission rendered illegal by virtue of such action by the Government or Relevant authority) or in violation of agreements to which the Concession Company is a party."

It will immediately be noticed that these clauses cover cases of impossibility of performance and cost increase at the same time, thus covering both *force majeure* and hardship situations.[8]

b. Combination With the Definition

In most cases, the events featured in the lists serve as illustrations of the meaning of *force majeure* as previously mentioned or defined. What, more precisely, is the relationship between the two?

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[8] Cf. *infra*, pp. 443–445.

First of all, lists are, in principle, stating examples. They are almost always introduced by an expression such as "in particular" or "for example," and/or are followed by "etc." or by an expression such as "or other similar circumstances." Here is a typical illustration:

> "Force majeure are contingencies caused by neither of the parties and which are unforeseeable at the time of concluding the Contract, uncontrollable and which render the further performance of the contractual obligations impossible as for instance acts of God, acts of war, acts of Government, blockages and revolutions and the like."

In very rare cases, the list appears limiting:

> "Special and excepted risks are: war, hostilities, . . . , any operation of the forces of nature as reasonable foresight and ability on the part of the Contractor could not foresee or reasonably provide against."

Furthermore, we have already cited certain clauses where the examples listed appeared to limit the instances of *force majeure* to certain types of disaster. Here is one such clause:

> "En cas de force majeure (incendies, inondations, tremblement de terre, épidémie et autres calamités). . . ."

The major problem in the relationship between the concept of *force majeure* and the list of instances is, however, knowing whether the circumstances considered always constitute cases of *force majeure* or only do so when they have the general characteristics of the notion. The events in question may in fact only be illustrations; but they can also appear in the lists because the parties wanted them to be considered as cases of *force majeure*, although not meeting the conditions for *force majeure*. Therefore, ambiguous drafting runs the risk of raising serious problems of interpretation. Consider the following clause:

> "By force majeure are to be meant extraordinary events independent of the Parties' will that cannot be foreseen or averted by them even with due diligence, being beyond their control preventing the Contracting Party or Parties to come up to his / their / obligation(s) undertaken in this Contract. Disasters, such as inundations, earthquake, stroke of lightning and war are to be considered as such events."

Are all inundations and all wars necessarily to be considered instances of *force majeure* as regards performance of the contract? Or are they simply

instances of *force majeure* if they fulfill the conditions set out in the first sentence of that clause? There are inundations that are foreseeable and there are wars that do not render performance of the contract impossible.

If the parties only intend to allow the events cited if they fulfill the general criteria, the drafting must be more precise on that point.

In the following clause, the words *selon le cas* appear to render the instances listed subject to the conditions in the preceding sentence:

> "Aucune des Parties ne sera responsable de la non-exécution des obligations qu'elle assume par le présent Contrat, s'il se présente des circonstances de Force majeure et/ou de Cas fortuit, c'est-à-dire n'importe quel événement ou circonstance indépendant et en dehors du contrôle des Parties. On considèrera Force majeure ou Cas fortuit, *selon le cas*, entre autres, la guerre (déclarée ou non), la rébellion . . ." [remainder of the list].

That wording creates doubt, however. It is preferable to use more explicit expressions, such as the following:

- ". . . sont notamment considérés comme causes d'exonération *s'ils interviennent après la conclusion du contrat et en empêchent l'exécution:* les conflits du travail et toutes autres circonstances telles que incendie, mobilisation . . . [remainder of the list], "*lorsque ces autres circonstances sont indépendantes de la volonté des parties.*"
- "The expression "force majeure" shall mean circumstances which were beyond the control of the party concerned exercising the standard of care of a reasonable and prudent operator. *Subject to the foregoing* and without limiting the generality of the foregoing the following circumstances in particular shall be regarded as force majeure: forces of nature, perils of navigation, . . . [remainder of the list], "or any other cause whether of the kind herein enumerated or otherwise *which is beyond the control of the party concerned exercising the standard of care of a reasonable and prudent operator.*"
- "(a) The expression "force majeure" shall mean circumstances (whether of the kind mentioned in subclause (b) of this Clause or otherwise) which were beyond the control of the party concerned and which by the exercise of due diligence and reasonable foresight it could not prevent or overcome.
  "(b) The circumstances which shall (*provided they fulfil the requirements of subclause (a) of this clause*) be within the definition of Force majeure shall include but shall not be limited to the following: acts of God or forces of nature. . . ."
- "Force Majeure may include, but is not limited to, exceptional

events or circumstances of the kind listed below, so long as conditions (a) to (d) above are satisfied. . . ."[9]

- "Force Majeure Events hereunder shall include each of the following events and circumstances, but only to the extent that each satisfies the above requirements."

c. Exclusions

Certain clauses take care to list events which, in principle, do not belong to *force majeure:*

- "Force Majeure Events shall expressly not include the following conditions, except and to the extent that they result directly from a Force Majeure Event:
  "(i) except as provided in Section 17.1(c)(i)(E), late delivery of machinery, equipment, materials spare parts or consumables (including fuel) for the Project;
  "(ii) a delay in the performance of any of the Contractors; or
  "(iii) normal wear and tear or random flaws in materials and equipment or breakdowns in equipment."
- "Pour l'application du paragraphe 1 ci-dessus, et sauf stipulation contraire dans le contrat, les empêchements ne comprennent pas l'absence d'autorisation, de licence, de visa d'entrée ou d'autorisation de séjour, ou d'approbations nécessaires à l'exécution du contrat et devant être délivrée par une autorité publique quelconque du pays de la partie qui demande l'exonération de sa responsabilité."[10]

Particularly elaborate contracts even come to distinguish among such exceptions, those that concern each party respectively:

> "16.1.2. Exceptions Applicable to the Company
> "The Company shall not have the right to consider any of the following circumstances to be an event of Force Majeure that would suspend the performance or excuse the non-performance of its obligations under this Agreement:
>
> "(a) any delay:

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[9] FIDIC Conditions of Contract for Construction, 1999, Art. 19.1; cf. Chr. R. Seppala, *op. cit.*, pp. 1019–1021.

[10] Clause quoted from the ICC Model International Franchising Contract, Paris, ICC, 2000.

"(i) in performance by any contractor or subcontractor of the Company, including the Construction Contractor . . . or any direct or indirect subcontractor to either of them; or

"(ii) in the delivery of equipment and machinery for the Project Facilities;

"except to the extent that such delay is itself caused by an event which satisfies the criteria set out in Article 16.1.1 in relation to both the Company and the relevant contractor or subcontractor;

"(b) any patent or latent defects in any materials, equipment, machinery and spare parts for the Project Facilities; or

"(c) breakdown or ordinary wear and tear of materials, equiment, machinery or parts of the project Facilities.

"16.1.3. Exceptions Applicable to the Government

- "The Governement shall not have the right to consider any of the following circumstances to be an event of Force majeure that would suspend the performance or excuse the non-performance of its obligations under this Agreement:

"(a) the expropriation, requisition, confiscation or nationalization of the Project facilities or any part thereof by a Government Authority;

"(b) the imposition of any blockade, import restrictions, rationing or allocation by a Government Authority;

"(c) insufficiency of the supply of raw water available to the Company in accordance with Article 10.1.2, except where and to the extent that such circumstances are caused by event described in Article 16.1.1(a);

"(d) non-compliance of the supply of raw water available to the Company with the Raw Water Quality in accordance with Article 10.4, except where and to the extent that such circumstances are caused by an event described in Article 16.1.1(a) or (b);

"(e) interruption in the supply of electricity to the project Facilities, except where and to the extent that such circumstances are caused by an event described in Article 16.1.1(a);

"(f) act of war (whether declared or undeclared), invasion, armed conflict or act of foreign enemy, riot, terrorism or exercise of military power that occurs inside the (Country); or

"(g) national, regional, city-wide or industry-wide strike ."

It will have been noticed that exclusions relating to *fait du prince* appear in the list applicable to governmental authorities.

B. Regime

When an event constituting *force majeure* has occurred, the clause describes the regime that applies to it. The first step is to notify the other contracting party that *force majeure* has arisen and to provide that party with proof. The clause then specifies the effects on the obligations of the parties: release from any liability, suspension of the obligation of performance. New obligations may then arise to use every possible means to remedy the impossibility of performance as soon as possible, and to notify the other party of the end of a situation of *force majeure.* If the situation carries on beyond a certain time limit, the contract may stipulate that the contract is to be re-negotiated or terminated. The specific case of obligations to pay money due will be discussed at the end.

1. Notice, Evidence

The occurrence of an event constituting *force majeure* has important effects on performance of the contract. It is therefore important for the other contracting party to be rapidly notified, and for the necessary proof to be submitted. However, many clauses covering *force majeure* fail to consider these aspects, and leave their solution to general principles, or even to *ad hoc* inspiration. It would seem preferable to avoid these uncertainties by deciding in advance the detailed procedure for notice and evidence. Here, in that connection, is what emerged from the analysis of clauses which pursued this course.

a. Notification

The *notice* requirement, when it is provided for, is generally coupled with conditions for form and time limits.

As regards *form,* it is sometimes merely required that notice be express:

"La partie qui invoque un cas de force majeure devra aussitôt adresser une notification *expresse* à l'autre partie."

More often, written notice is required:

"Upon the occurrence of any such contingencies the party suffering therefrom shall immediately give the other party notice in *writing* of the cause of delay. . . ."

Occasionally, notice is to be given by registered letter or by an accelerated means of communication (formerly cable, telex or telegram, nowadays facsimile or electronic mail), or even by a combination of two of these methods:

- "La partie qui invoque le cas de force majeure devra, aussitôt après la survenance, adresser une notification expresse et *recommandée* à l'autre partie."
- "The concerned party has to notify the other party of setting in of the events mentioned in §17.0 immediately by *cable* and confirm it by a *registered mail letter.*"
- ". . . la partie affectée par le cas de Force majeure informe(ra) l'autre par écrit dans un délai d'au moins . . . jours, et si cela est nécessaire par télex ou télécopie, de la survenance de l'événement. . . ."[11]

Another option is notice by telephone to be confirmed in writing:

"The party claiming force majeure shall notify the other party of said force majeure event promptly after the occurrence thereof *by telephone* which shall be confirmed *by telex or telegram* as soon as possible."

More recent versions of such clauses would of course refer to e-mail and fax.

Notice must, of course, be given *as soon as possible.* As we have seen in several of the examples cited, many clauses merely lay down the requirement that notice be given "as soon as possible" or "immediately." Sometimes, however, they provide a specific time limit; in the sample of clauses that were submitted to the Group, there were time limits of seven, 15, 21 and 30 days. In another example, notice was to be given "within a reasonable time."

The clause may cover the case when the possibility to give immediate notice is itself hindered by the *force majeure* event:

"If the Force Majeure Event results in a breakdown of communications rendering it reasonably impracticable to give notice within

[11] Clause quoted from the ICC Model International Franchising Contract, Paris, ICC, 2000.

such period, then the Party affected by the Force Majeure Event shall give such notice as soon as reasonably practicable after the reinstatement of communications, but not later than 24 hours after such reinstatement."

A time limit only makes sense if its *starting point* is known. Those drawing up clauses are not always aware of this. When they are, the time limit usually starts to run from the occurrence of the event; a better solution for the person under the obligation is provided in the following clause:

"Le vendeur notifiera à l'acheteur l'existence d'un tel cas, dans les trente jours de son apparition, ou *de la date à laquelle il est venu à sa connaissance.*"

Some clauses provide for notification in two stages, possibly followed by further notices:

"If by reason of a Force Majeure Event a Party is wholly or partially unable to carry out its obligations under this Agreement, the affected Party shall

"(i) give the other Party notice of the Force Majeure Event(s) as soon as practicable, but in any event, not later than the later of forty-eight (48) hours after the affected Party becomes aware of the occurrence of the Force Majeure Event(s) or six (6) hours after the resumption of any means of providing notice between the Company and the GOVERNMENT, and

"(ii) give the other Party a second notice, describing the Force Majeure Event(s) in reasonable detail and, to the extent that can be reasonably determined at the time of the second notice, providing a preliminary evaluation of the obligations affected, a preliminary estimate of the period of time that the affected Party will be unable to perform the obligations, and other relevant matters as soon as practicable, but in any event, not later than seven (7) days after the initial notice of the occurrence of the Force Majeure Event(s) is given by the affected Party.

"When appropriate or when reasonably requested to do so by the other Party, the affected Party shall provide further notices to the other Party more fully describing the Force Majeure Event(s) and its cause(s) and providing or updating information relating to the efforts of the affected Party to avoid and/or to mitigate the effect(s) thereof and estimates, to the extent practicable, of the time that the affected Party reasonably expects it will be unable to

carry out any of its affected obligations due to the Force Majeure Event(s)."

This gives the other party the most complete information, not only on the occurrence of the event but also on its effects on the contract.

b. Evidence

The party invoking *force majeure* must provide *evidence* of it. This is doubtless the case under the ordinary law, but certain clauses provide detailed rules governing evidence.

Sometimes, the notice discussed above must be given together with the necessary proof:

"Cette notification devra être accompagnée de toutes les informations circonstanciées utiles. . . ."

More often, since notice must be given rapidly and gathering the evidence may take a certain time, evidence may be supplied later, if necessary within a new time limit:

- "Après cette notification seront envoyées toutes les informations circonstanciées. . . ."
- "Les preuves officielles du cas signalé seront . . . fournies dans les 30 jours à compter de la date de notification du cas de "force majeure," en même temps qu'une indication sommaire des conséquences possibles sur les conditions de livraison."

What constitutes proof? Some of the preceding examples merely require *informations circonstanciées* (detailed information). The last clause refers to *preuves officielles.* In other cases, trustworthy documents are required, or certificates from the competent authorities:

"Les cas de force majeure . . . ne peuvent être opposés à l'autre partie qu'à condition de lui avoir communiqué, dans un délai de 21 jours de leur apparition, par lettre recommandée, le commencement et la fin de la force majeure invoquée, en annexant à cette communication *un certificat des autorités compétentes* attestant la réalité et l'exactitude des faits et dates allégués."

What are these competent authorities? It could be, for example, the meteorological institute (in case of storm), the railway company (in case of railway accident) or the police (in case of theft).

The competent authority may be an international institution:

"The following prevailing conditions between Effective Date and Financial Close, as supported by appropriate written evidence, shall constitute a Financial Market Disruption:

"(1) International Finance Corporation (IFC) certifying to Government that IFC are ceasing or will not lend funds to the Project based upon a reasonable assessment of the risk of lending into the AAMB Country generally; or

"(2) IFC certifying to Government that IFC has insufficient funds to finance the Project due to a disruption in the international finance markets."

Parties may also accept evidence given by an independent third party:

"The Party so affected shall arrange for the occurrence of the event to be certified to the other Party by the Independent Engineer or some other mutually acceptable third party."

In contracts concluded with socialist countries, *Chambers of Commerce* used to be given a prominent role:

- "At the party's request the party suffering the force majeure event is obliged to make the Chamber of Commerce of his country testify the event."
- "La confirmation de l'annonce est à ratifier par la Chambre locale de l'industrie et du commerce et par le Conseiller commercial de la R.P. de Pologne à Bruxelles."[12]

c. Remedies

What should be the *remedies* for failing to meet the requirements to give notice and evidence of *force majeure*?

A first option is to make the person under the obligation responsible for making good the damage resulting from the lateness in performing the required formalities. Here is an example:

"Vous devez nous signaler toutes les causes de retard dès qu'elles appairaîtront, de manière que nous puissions prendre toutes dispositions utiles, en particulier vis-à-vis des clients, faute de quoi

[12] Note in that last clause the additional intervention of a diplomat from the country of the other contracting party. The role thus given to Chambers of Commerce used to raise certain questions: cf. the first French edition of this book, *Droit des contrats internationaux*, Paris, 1989, p. 244.

vous serez tenus pour responsables des préjudices qui en résulteraient pour notre société."

Occasionally, the party under the obligation may invoke the suspension of his obligations only as from when he gave notice:

- "Tout cas de force majeure ou assimilé . . . suspend l'éxécution de la présente convention . . . à partir du moment où la partie intéressée a informé l'autre. . . ."
- "Failure by the affected Party to give notice of a Force Majeure Event to the other Party within the forty-eight (48) hour period or six (6) hour period required by Section 17.2(a) shall not prevent the affected Party from giving such notice at a later time; provided, however, that in such case, the affected Party shall not be excused pursuant to Section 17.4 for any failure or delay in complying with its obligations under or pursuant to this Agreement until the notice required by Section 17.2(a)(i) has been given."

More often, a more radical sanction is stipulated: lateness in complying with formalities entails the loss of the right to invoke the clause excusing performance:

- "Tout retard pour cas de force majeure, non notifié dans les conditions et formes ci-dessus, ne sera en aucune façon retenu pour le décompte du delai contractuel."
- "A défaut de notifier les cas ou de fournir les preuves dans les délais impartis, le droit du vendeur de demander une prolongation de délai est frappé de prescription pour ce cas considéré."
- "La partie qui n'a pas respecté cette condition sera réputée avoir pris à charge irrévocablement les risques et toutes les conséquences de la force majeure respective."
- "Si la partie contractante se dérobe à son obligation d'informer l'autre partie par telex, elle ne pourra plus invoquer le cas de force majeure."

What remedy is to be applied in the many cases where the clause has made no provision? Most of the members of the Group considered that it should be the loss of the right to invoke the *force majeure* clause. Others consider that sanction to be too severe, given the difficulty for the party under the obligation to assess from the outset whether a given incident will constitute an obstacle of *force majeure* with regard to the performance of its obligations (the length of a strike, for example, is not always foreseeable at the start). Should it then give notice of it? Should it suffer such a severe sanction for not having done so immediately? There was general agreement, in any event that the obligor will not suffer a penalty if the lateness

in giving notice is due to the *force majeure* itself (for example an interruption in communications), a hypothesis that certain clauses explicitly cover.[13]

2. Exemption From Liability

The occurrence of a *force majeure* event will, at least temporarily, prevent performance of certain obligations arising from the contract, under conditions that exclude any liability on the part of the obligor. The effect of *force majeure* of excusing performance is self-evident as far as the drafters of most of the clauses were concerned, since they do not mention it explicitly. However, here are a few examples where that point is stressed:

- "The Contractor shall not be responsible for any harm or damages that are due to force majeure. . . ."
- "Neither party shall be deemed to be in default of its contractual obligations whilst performance thereof is prevented by force majeure. . . ."
- "No indemnity shall be claimed by either party in case of force majeure."
- "Pour les retards et non-exécution des obligations due à la force majeure, aucune partie ne peut réclamer à l'autre des pénalités, des intérêts ou tout autre dédommagement ou participation au préjudice souffert par elle à cause de la force majeure."

Certain clauses make it clear that *force majeure* cannot exempt from liability non-performance resulting from other causes that may be imputable to the obligor:

- "Provided, however, that no relief, including without limitation, the extension of performance deadlines, shall be granted to the affected Party pursuant to this Section 17.4 to the extent that such failure or delay would have nevertheless been experienced by the affected Party had the Force Majeure Event not occurred."
- ". . . except under circumstances where such governmental action or omission is in response to any act or omission on the part of the Concession Company which is illegal (other than an act or omission rendered illegal by virtue of such action by the Government or Relevant authority) or in violation of agreements to which the Concession Company is a party."

3. Suspension of Performance

Whereas the classical theory, built around simple contracts, where performance is instantaneous, emphasizes the extinguishing effect of *force*

[13] Cf. *supra*, pp. 419–420.

majeure (the obligation is extinguished), the practice in international contracts shows that initially, at least, *force majeure* only has a suspensive effect.

Suspension may, however, be dealt with in several ways.

a. Extending the Duration of the Contract

The first method, most commonly found, has the effect of *extending the time limits for performance equal to the time during which performance is suspended:*

> ". . . les obligations affectées par la force majeure sont prorogées automatiquement d'une durée égale au retard entrainé par la survenance du cas de force majeure."

While a formula is frequently found, occasionally the prolongation is not necessarily of the same duration as the period of suspension:

- ". . . les délais de livraison seront prolongés d'une durée raisonnable tenant compte des circonstances."
- "Au cas où la partie empêchée par un cas de force majeure estimerait que l'incidence sur les délais est supérieure à la durée même du cas de force majeure, elle se rapprocherait de l'autre partie pour arrêter, en commun, la durée du retard."
- ". . . the delivery periods shall be increased as far as necessary to compensate the reduction in deliveries caused by force majeure."

b. Suspension Without Extension

Another possibility is *to suspend performance* but *not to prolong the duration of the contract,* which is therefore irremediably reduced by part of its duration, and, in certain cases, part of performance is cancelled:

- ". . . the party so prevented or delayed shall be excused from such performance to the extent and during the period of prevention or delay, without, however, extending the term of this Agreement."
- "Pendant la durée de la force majeure, le présent contrat suspendera ses effets jusqu'au rétablissement normal de la situation, la durée des présentes n'étant en aucun cas prolongée des périodes de suspension éventuelles et les quantités non livrées étant purement et simplement annulées."
- "Any quantity of . . . which is not shipped from port of loading . . . due to suspension of this Agreement shall be cancelled from this Agreement unless otherwise agreed within 15 days of the date of the declaration of force majeure hereunder."

It is important to specify whether or not suspension of the contract prolongs time limits. Clauses that do not clarify this matter can lead to obvious problems of interpretation.

c. Procurement Contracts

In *procurement contracts,* suspension in the supplies clearly risks placing the other contracting party in a difficult position.

Is the buyer provisionally entitled *to obtain supplies elsewhere?* That is expressly provided for in one clause:

> "Buyers shall be at liberty to procure from other suppliers any deficiency of deliveries caused by the operation of this clause."

But that option is implicitly excluded in another contract:

> "The orders corresponding to the suspended deliveries shall accordingly be cancelled, this Agreement remaining in force."

The final words refer, *inter alia,* to the obligation of exclusivity.

Moreover, it is possible that the seller has several clients, and that the *force majeure* event only has the effect of reducing supplies. Several clauses anticipated that situation and provided for proportional allocation:

- "If, by a reason of any such contingencies, seller is unable to supply the total demands upon it for the material or materials covered by this Agreement, seller, without liability, may allocate its available supply pro rata among its contract customers and for its manufacturing purposes."
- "In case the Party affected by Force Majeure is Seller, Seller shall fairly allocate product produced by it in Antwerp proportionally among its own requirements and these of its long term customer under running sales contracts, inclusive of Buyer."
- "If, owing to any event of Force Majeure as described hereinabove, Company X was driven to reduce its supplies of . . . , Company X shall make sure that the reduction of these supplies will not be proportionally bigger than the one applied to other purchasers of the same supplies."

These three examples offer interesting variations. The supplier may want to secure his own needs, but each client will not necessarily receive the same allocation.

d. Unilateral Clauses

The suspension of the obligations affected by *force majeure* results most often from the automatic application of the contractual clause. Sometimes, however, it is left to the *discretion of the other contracting party:*

"Des prolongations de délais d'exécution *pourront être accordées par l'acheteur* au vendeur dans le cas où celui-ci serait empêché ou retardé dans l'exécution du contrat par suite d'un cas de force majeure. . . ."

Conversely, some clauses leave *the party under an obligation great latitude:*

". . . nous nous réservons le droit de suspendre, de limiter ou d'ajourner partiellement ou totalement nos livraisons ou bien de renoncer à la partie non exécutée du contrat sans aucune obligation de dédommagement."

e. Costs Incurred by the Parties

What of the *expenses* resulting from the *suspension* for the party under obligation who invokes *force majeure*? Costs may be considerable: warehousing expenses for supplies whose delivery has been prevented, expenses of temporarily keeping personnel on the spot, etc. Those expenses are linked to the obligation to use all possible means to ensure that performance of the contract resumes as soon as possible.[14]

On the other hand, the suspension may also cause prejudice to the other party. In principle, the exculpatory effect of *force majeure* exempts the obligor from any obligation to indemnify, but such consequences also deserve attention.

The clauses examined are often silent on these points.

Sometimes, the general nature of the clause relating to the effect *force majeure* has of excusing performance, while denying any right to compensation for *either* of the parties, leads to the conclusion that both parties are to bear their respective expenses:

"Pour les retards et non-exécution des obligations dûs à la force majeure, aucune partie ne peut réclamer à l'autre des pénalités, des intérêts ou tout autre dédommagement ou participation au préjudice souffert par elle à cause de la force majeure."

There seems to be an evolution towards a better understanding of the potential seriousness of the effects of *force majeure* during the period of suspension. This appears in the following clauses, which deal with the problem of costs linked to the extension of time limits:

[14] Cf. *infra* point 4.

- "S'il se produit des circonstances ou des événements de force majeure et/ou de cas fortuit, chacune des parties pourra suspendre tout ou partie de l'ouvrage ou de ses obligations contractuelles . . .
  "Dans cette éventualité, la période de suspension et la détermination du coût, des pertes et/ou des dommages qui pourraient découler de cet événement, seront décidées moyennant des négociations directes et amiables entre les parties. . . ."
- "If the Contractor is prevented from performing any of his obligations under the Contract by Force Majeure of which notice has been given under Sub-Clause 19.2 (Notice of Force Majeure), and suffers delay and/or incurs Cost by reason of such Force Majeure, the Contractor shall be entitled subject to Sub-Clause 20.1 (Contractor's Claims) to:
  "(a) an extension of time for any such delay, if completion is or will be delayed, under Sub-Clause 8.4 (Extension of Time for Completion), and
  "(b) if the event or circumstance is of the kind described in sub-paragraphs (i) to (iv) of Sub-Clause 19.1 (Definition of Force Majeure) and, in the case of sub-paragraphs (ii) to (iv), occurs in the Country, payment of any such Cost."[15]

Certain recent contracts deal with the problem of costs in a very elaborate manner. In a contract concerning investments in a Northern African country, the Group has found an extensive clause (15 pages), entirely devoted to the arrangement of the financial consequences of *force majeure*. This clause provided for payment of compensation, fully describing modes of evaluation.

4. *Efforts to Overcome the Obstacle of Force Majeure*

With the proviso of the relaxations described above, an event of *force majeure* is, in principle, unforeseeable and unavoidable when it occurs. However, once the event has occurred, it is often possible to act in such a way as to re-establish the conditions enabling performance of the contract to be resumed. Many *force majeure* clauses make this an express obligation:

> "Dans tous les cas, la partie concernée devra prendre toutes dispositions utiles pour assurer dans les plus brefs delais, la reprise normale de l'exécution des obligations affectées par le cas de force majeure et réduire au maximum le retard subi."

It is sometimes provided that the other contracting party is to be kept informed of the measures taken to that effect:

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[15] FIDIC Conditions of Contract for Construction, 1999, Art. 19.4; cf. Chr. R. Seppala, *op. cit.*, pp. 1019–1021.

> "... (la partie affectée par la circonstance de force majeure) prendra les mesures nécessaires et réalisera les efforts correspondant aux circonstances pour dominer cette situation, en donnant avis officiel de ses actions à l'autre partie aux fins pertinentes."

Often, the obligation is placed on both parties:

- "... parties shall exercise all due diligence to minimize the extent of the prevention or delay in the performance of the contract generally."
- The Contracting Parties have to act both during the force majeure event and with respect to its consequences in compliance with the principle of 'Bona Fides' in view of realizing the economical aim defined in chapter 1, so as to remedy the loss of time caused by the force majeure case as soon as possible and to get the contractual obligations performed within the shortest possible time."
- "In case of "Unabwendbare Gewalt" the parties must make all reasonable efforts to eliminate or overcome the consequences of such an event. In this regard the parties shall work closely together and shall establish a new delivery plan within the limits of their possibilities. The parties are to keep the damages resulting from "Unabwendbare Gewalt" as small as possible and to take whatever measures are necessary in this regard."

The normal remedy for breach of such an obligation is the payment of damages. That is explicitly provided in the following clause:

> "En cas de force majeure, les parties contractantes sont tenues de conduire tous les efforts nécessaires dans le but de supprimer et/ou de diminuer les difficultés et les dommages provoqués, auquel cas l'autre partie sera constamment tenue au courant de la situation. Dans le cas contraire, la partie défaillante pourra se voir réclamer des dommages et intérêts par l'autre partie."

This obligation to exert one's efforts in order to overcome the obstacle generated by *force majeure* can be compared to the duty to mitigate loss, more and more recognized within the context of contractual liability (see, e.g., Article 77 of the Vienna Convention of the International Sales of Goods and Article 7.4.8 of the Unidroit Principles). It emerges from the same spirit.

5. *The End of the* Force Majeure*: Notice*

The occurrence of a *force majeure* event must be often notified to the other contracting party. Some clauses also provide for notice to be given of the end of the *force majeure* event:

- "The Contractor shall forthwith notify the Buyer as soon as the said Special and Excepted Risks have ended."
- "The termination of the force majeure shall similarly be notified."
- "The affected Party shall also provide notice to the other Party of
  "(i) with respect to an ongoing Force Majeure Event, the cessation of the Force Majeure Event, and
  "(ii) the affected Party's ability to recommence performance of its obligations under this Agreement
  "as soon as possible, but in any event, not later than seven (7) days after the occurrence of each of (i) and (ii) above or, where the affected Party has (acting reasonably) vacated the Site, or its relevant property, as the case may be, as a result of such Force Majeure Event, not later than seven (7) days after the date it becomes or should have become aware of such occurrence."

6. *Termination, Re-Negotiation*

The suspension of the obligations resulting from *force majeure* cannot be prolonged indefinitely. Most of the clauses provide that, after a certain time limit, and if the *force majeure* events have not ended, the contract may be terminated or re-negotiated (re-negotiation itself may lead to termination).

a. Possible Termination

Some clauses only included the possibility of *termination*, at the instigation of one of the parties, at the end of a fixed time limit, which varies according to the different contracts (from 30 days to one year in our sample, or a "reasonable period").

In general, it is the contracting party, other than the one whose obligations are suspended, that may terminate the contract:

- "Si ces circonstances se prolongeaient plus de six mois, l'autre partie serait en droit de refuser l'exécution ultérieure des obligations contractuelles."
- "Si le retard de livraison de l'équipment de l'installation pour des raisons de force majeure dépasse six mois, l'acheteur a le droit d'annuler (*sic*) le contrat. . . ."

Less frequently, the party under obligation, who is affected by the *force majeure*, may terminate the contract:

> "If, after 180 days from the date of the aforesaid notice to one party, the other party shall still be prevented, by the cause as to which it gave notice, from continuing with its performance of the work, then said party shall be entitled to terminate this contract. . . ."

Some contracts confer a right to terminate on each of the parties:

- "Dans le cas où la durée des circonstances de force majeure affectant tout ou partie des engagements dépasserait un an, chacune des parties aurait le droit de se dégager du contrat par simple notification écrite, sans devoir demander la résiliation à un tribunal."
- "If the execution of substantially all the Works in progress is prevented for a continuous period of 84 days by reason of Force Majeure of which notice has been given under Sub-Clause 19.2 (Notice of Force Majeure), or for multiple periods which total more than 140 days due to the same notified Force majeure, then either Party may give to the other Party a notice of termination of the Contract. In this event, the termination shall take effect 7 days after the notice is given, and the Contractor shall proceed in accordance with Sub-Clause 16.3 (Cessation of Work and Removal of Contractor's Equipment)."[16]

In certain cases, it appears that the occurrence of the *force majeure* event immediately renders performance impossible or illegal. There is then no reason to provide for an initial period of suspension. FIDIC contracts envisage such a situation, where termination is directly envisaged:

> "Notwithstanding any other provision of this Clause, if any event or circumstance outside the control of the Parties (including, but not limited to, Force Majeure) arises which makes it impossible or unlawful for either or both Parties to fulfil its or their contractual obligations or which, under the law governing the Contract, entitles the Parties to be released from further performance of the Contract, then upon notice by either Party to the other Party of such event or circumstance:
>
> "(a) the Parties shall be discharged from further performance, without prejudice to the rights of either Party in respect of any previous breach of the Contract, and
>
> "(b) the sum payable by the Employer to the Contractor shall be the same as would have been payable under Sub-Clause 19.6 (Optional Termination, Payment and Release) if the Contract had been terminated under Sub-Clause 19.6."[17]

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[16] FIDIC Conditions of Contract for Construction, 1999, Art. 19.6; cf. Chr. R. Seppala, *op. cit.*, pp. 1019–1021.

[17] FIDIC Conditions of Contract for Construction, 1999, Art. 19.7; cf. Chr. R. Seppala, *op. cit.*, pp. 1019–1021.

b. Re-Negotiation

More often, *force majeure* clauses provide that the parties will review matters if the suspension due to *force majeure* goes on beyond a fixed time limit. The purpose of *re-negotiation* would then be to adapt the contract.

- "If the effect of Force Majeure continues for more than 120 days both parties shall settle the problem of further execution of the Contract by friendly negotiations and reach an Agreement as soon as possible."
- "Si un cas de force majeure durait plus de 2 mois, les deux parties contractantes se mettront d'accord en ce qui concerne l'exécution ultérieure du contrat vu les circonstances survenues."

Such clauses are clearly dangerous because they do not provide for any solution in the event that the "friendly" negotiations do not lead to any agreement.

Other drafters did make provision for that possibility, and agreed to refer to arbitration:

> "Si la force majeure s'étendait sur plus de quatre mois, l'Acheteur et le Vendeur entreprendraient immédiatement de nouvelles négociations dans le but de prendre les mesures qui paraissent le plus appropriées pour atteindre le but du contrat. Si dans les deux mois suivants aucune solution n'a été trouvée, il est décidé d'aller en arbitrage."

Another possibility is to allow the contract *to be terminated* if agreement cannot be reached as to its amendment:

- "Si, pour une cause de force majeure, l'une des parties est empêchée de remplir ses obligations contractuelles pendant une période supérieure à trois mois, les parties se rencontreront pour déterminer les conditions de poursuite de l'exécution du contrat ou de sa résiliation."
- "In case force majeure lasts continuously for at least six months, then both parties shall meet to consult and agree on the necessary arrangements for the further implementation of the contract. In case the further implementation is unforeseeable and impossible, then both parties shall arrange for the termination of the contract. . . ."
- "Si un cas de force majeure durait plus de 6 mois, les parties contractantes devraient se mettre d'accord en ce qui concerne l'exécution ultérieure du contrat, vu les circonstances survenues. Au cas où aucune solution ne serait envisageable, les parties auront la possibilité de résilier le contrat."

These clauses may very well give rise to difficulties. Failing agreement on adjusting the contract, will the parties be able to agree to terminate it? The first two clauses seem to allow termination of the contract only by mutual agreement; the third is ambiguous on the point. It would be preferable to be more precise regarding the option to terminate the contract in the event that no other agreement can be reached (Who may terminate? Within what time limits? In what form?). Here are two examples:

- "Si un cas de force majeure provoque un retard dans les livraisons supérieur à 8 mois, les deux parties seront obligées de se mettre d'accord, dans un délai supplémentaire d'un mois, sur un nouveau délai de livraison. Si, à l'expiration de ce mois supplémentaire, les deux parties ne se sont pas mises d'accord, la partie du contrat relative à l'unité pour laquelle cet équipement est en retard de plus de 8 mois du fait de la force majeure pourra être resiliée, partiellement ou totalement, par l'acheteur. . . ."
- "Dans l'hypothèse où les Parties n'aboutiraient pas à un accord sur la solution à être adoptée dans un délai de 30 (trente) jours comptés du début des négociations, chacune des Parties aura le droit de résilier cet Accord, sans aucune pénalité."

Two other clauses examined by the Group provide for the intervention of arbitrators in such circumstances.

- "Dans le cas où le cas de force majeure se prolongerait de plus d'un mois, l'Acheteur et le Vendeur auront des négociations concernant la prorogation ou l'annulation (*sic*) du Contrat. Dans le cas où il n'y aurait aucun accord, les parties contractantes ont le droit de recourir à la Cour d'Arbitrage selon l'article 15 du présent Contrat. L'Acheteur et le Vendeur s'engagent à reconnaître la décision de la Cour d'Arbitrage comme obligatoire."
- "Si le retard dû à la Force majeure dépassait 8 mois, la partie à laquelle elle fut opposée a le droit, faute d'autre accord, de demander la résiliation du contrat à l'instance arbitrale qui statuera sur la liquidation des rapports entre les parties."[18]

In all the preceding cases, re-negotiation took place only after the expiry of a fixed time limit. Some clauses, however, provide for immediate re-negotiation, right after the occurrence of a *force majeure* event whose repercussions appear substantial:

[18] On the intervention of arbitral institutions in case of *force majeure* in countries then belonging to Comecon, cf. H. Strohbach, Force majeure and Hardship Clauses in International Commercial Contracts and Arbitration, *Journ. of Int. Arb.*, 1983, pp. 49–50.

- "... the Contracting Parties shall enter immediately into negotiations with each other concerning further performance of the contractual obligations, if the force majeure event and its expected consequences will cause a delay of 90 or more days in meeting with the contractual obligations."
- "Les Parties se réuniront dans un délai de 10 (dix) jours à compter de la réception de ladite notification afin de négocier et mettre en place, en toute bonne foi, la solution la plus adaptée à la résolution des troubles causés par la force majeure, que la solution trouvée soit la suspension du contrat, sa modification ou encore sa résiliation."

Lastly, here is a clause that does not make re-negotiation compulsory as a result of the contract itself, but by virtue of a new agreement, which is to come into force in the event of *force majeure:*

> ". . . in the event of a delay caused by an occurrence of force majeure continuing for period exceeding 180 days from the date of the notice referred to in subarticle 2 of this Article, and provided that there has not within this period been prior agreement between the two parties in writing to renegotiate the terms upon which the Contract should be continued, then either party may express his intention by 30 days notice in writing that the Contract is as an end. . . ."

c. Re-Negotiation or Termination

The following clause immediately gives the choice between re-negotiation and termination at the expiry of a first time limit:

> "If the delay due to force majeure in the fulfilment of any of the parties' obligations exceeds three (3) months from the date of the force majeure, either the parties shall meet to consider the conditions of their continuing relationship by mutual agreement or this contract shall be automatically terminated at the request of either party."

d. Winding Up

If the contract is terminated, the problem of *winding up* the contractual relationship will arise. Many *force majeure* clauses contain no specific provisions in this regard. Occasionally, an explicit reference is made to the clause in the contract which deals with the question of termination in general:[19]

> "... in which case the amounts due as between the parties shall be settled in accordance with Article 'Termination'."

[19] On termination clauses, see *infra*, Chapter 12.

Occasionally, the clause entrusts the resolution of any problems that could arise out of termination to an arbitrator:

> "Faute d'accord amiable, la liquidation des rapports contractuels sera soumise à l'Arbitrage prévu à l'article39."

More and more frequently, however, clauses lay down a regime for termination specific to cases of *force majeure*. Here are two examples. Such provisions must undoubtedly be specifically adapted to the subject matter of the contract in which they are included:

- ". . . le Vendeur s'engage, dans ce cas, à remettre à l'Acheteur tous les dessins (y compris les dessins d'exécution) et toute la documentation technique nécessaire à la fabrication de la partie d'équipement non livrée, pour compléter l'installation."
- "If Force Majeure or abnormal circumstances, as stated above, shall call for termination of the Contract, the Ministry shall pay the Contractor the following:
  "1) The amounts payable in respect of the preliminary items as far as the work or service comprised therein has been carried out or performed, and a proper proportion as certified by the Engineer of any such items, the work or service partially carried out or performed.
  "2) The cost of materials or goods reasonably ordered for the works or temporary works which shall have been delivered to the Contractor or of which the Contractor is legally liable to accept delivery (such materials or goods becoming the property of the Ministry upon such payment being made by them).
  "3) Any additional sum or sums that shall become due in accordance with the provisions of Paragraph 1) of this clause.
  "4) The reasonable cost of repatriation of all the Contractor's staff and workmen employed on or in connection with the works at the time of such termination. In all cases, the Ministry shall be entitled to retain any sum or sums owed by the Contractor by way of advance payments or paid to the Contractor on account of construction, or in any manner pertaining to the construction."

The ICC Model Franchising Contract prefers to cover the problem of winding up by a clause drafted in very general terms:

> "Chaque partie peut conserver ce qu'elle a obtenu grâce à l'exécution du contrat avant qu'il n'y soit mis fin. Chaque partie est comptable envers l'autre de tout enrichissement sans cause résultant de cette exécution. Le paiement du solde final se fera sans délai."[20]

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[20] ICC Model International Franchising Contract, Paris, ICC, 2000, Annex 13, No. 9.

7. Obligations to Pay a Sum of Money

Despite the existence of obligations to pay sums of money (the price, rental payments, fees, interest, etc.), in most contracts, very few *force majeure* clauses deal with the specific problems arising out of this type of obligation.

In principle, by virtue of the rule *genera non pereunt*, the payment of a sum of money is never rendered impossible by the occurrence of *force majeure*. If the clause refers to the traditional criteria for *force majeure*, it is probably not necessary to specify the position regarding obligations to pay a sum of money, since it will be sufficient to apply the principles. Here, however, are two rare examples of express mention:

- "If a force majeure event occurs, the obligations of the parties are suspended, except for payment of money due."
- "Notwithstanding any other provision of this Clause, Force Majeure shall not apply to obligations of either Party to make payments to the other Party under the Contract."[21]

In international trade, however, the situation is often more delicate.[22] Intervention by a State may, for example, prevent the transfer of funds, and may, in this regard, be a cause of *force majeure* preventing performance of the obligation to pay money due, unless the debtor has an alternative means of settlement. Additionally, the substituted procedure must also satisfy the creditor. If the contract provides for a payment of dollars in Italy, the debtor does not fulfill his obligations if he makes the payment in euros in Germany. Sometimes, leaving aside any *fait du prince*, certain currencies may be unavailable at the time of payment. It may be appropriate to provide for that eventuality, as illustrates this clause taken from a contract relating to the euro currency market:

> "If, by reason of the non-availability to the Bank of eurodollars in the London interbank eurocurrency market, it becomes impossible for the Bank to make or continue to make the Commitment available on the basis contemplated by this agreement, the Bank shall promptly so notify the Borrower whereupon the Bank and the Borrower shall search for an alternative basis for continuing the Commitment whether by making the Commitment available from some source other than the London interbank eurocurrency market or from other branch or branches of the Bank. If such alternative is not available or is not acceptable to the Borrower the

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[21] FIDIC Conditions of Contract for Construction, 1999, Art. 19.2; cf. Chr. R. Seppala, *op. cit.*, pp. 1019–1021.

[22] In a particular sector, cf. G.R. Delaume, Change of circumstances and *force majeure* clauses in transnational loans, *D.P.C.I.*, 1981, pp. 333–359.

Bank shall make available in the New York market to an American subsidiary of Borrower, under the guarantee of the Borrower, dollars at a rate equal to the rate at which the Bank would make an Advance to a major United States domestic company in similar amounts and maturities."

The drafters of clauses should be mindful of the possible repercussions when the requirements of *force majeure* are loosened regarding obligations to pay sums of money due. If the clause does not require impossibility of performance but only excessive difficulty as compared with the usual practices, the rule *genera non pereunt* no longer necessarily applies. Could a debtor deprived of one source of finance, in order to release himself, rely on the excessively onerous nature of alternative sources of finance?

Certain financial operations may also be prevented by troubles forcing the lender to suspend his services. The following clause gives a definition of the *Financial Market Disruption*, which causes the contract to be suspended:

"The following prevailing conditions between Effective Date and Financial Close, as supported by appropriate written evidence, shall constitute a Financial Market Disruption:

"(1) International Finance Corporation (IFC) certifying to Government that IFC are ceasing or will not lend funds to the Project based upon a reasonable assessment of the risk of lending into the AAMB Country generally; or

"(2) IFC certifying to Government that IFC has insufficient funds to finance the Project due to a disruption in the international finance markets."[23]

8. *Insurance Covering* Force Majeure *Events*

Certain *force majeure* events can be insured. The following clause takes this circumstance into consideration when providing for the consequences of the occurrence of such events:

"18.1.3 Insured Events of Force Majeure

"18.1.3.1. To the extent that the consequences of an event of Force Majeure fall within the terms of the insurance cover required by Clauses 17.1 and 17.2, then the Concession Company shall forthwith make the appropriate claims thereunder and shall apply the proceeds as required by Clauses 17.5.4. and 17.5.5.

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[23] Clause already quoted *supra*, p. 422, in connection with problems of evidence.

"18.1.3.2. In the event insurance cover is available but is materially insufficient in accordance with normal construction practice to complete or repair the Motorway to an operational condition, the Parties shall meet to discuss whether and how the provisions of Clause 19 hereof shall apply or whether in conjunction with Clause 18.3 hereof some other remedy is available for the continued completion and operation of the Motorway."

9. *Differentiated Regime for Each Party*

Some elaborate recent contracts provide for differentiated regimes depending on which party's obligations are affected by *force majeure*.

Such a clause defines in very long provisions the consequences of *force majeure* affecting the obligations of the contracting State and of the party in charge of performing the project. Here are two typical excerpts:

"20.3. Circonstance de Force Majeure affectant les obligations de l'Etat

. . .

"20.3.4. Lorsqu'une Phase de la centrale peut techniquement être mise en service mais que la circonstance de Force Majeure affectant les obligations de l'Etat (y compris, en particulier, en cas d'impossibilité pour l'Etat de fournir le combustible requis ou de prendre livraison de l'énergie électrique) empêche cette mise en service, la Phase est réputée mise en service à la date à laquelle la Phase aurait pu effectivement être mise en service si les obligations de l'Etat avaient pu être accomplies dans le délai requis et les stipulations du Paragraphe 20.3.5 ci-après sont applicables, le cas échéant.

. . .

"20.3. Circonstance de Force Majeure affectant les obligations de la Société

. . .

"20.4.3. Dans l'hypothèse où la circonstance de Force Majeure résulte d'une circonstance autre qu'une Circonstance intérieure de Force majeure et qu'il en résulte une diminution de Puissance Réelle de la Centrale de plus de quarante-cinq pour cent (45 %) pendant vingt (20) jours consécutifs ou pendant plus de trente (30) jours au cours d'une année, la rémunération Mensuelle de la

Société . . . est réduite, lorsque cette limite est atteinte, pour tenir compte de la diminution de la Puissance Réelle . . . Pendant cette période, les pénalités PNF_n et R_n ne seront pas appliquées.

. . ."

III. CRITICAL CONSIDERATIONS

The first part of this review described and illustrated the principal elements of a *force majeure* clause. Attention was drawn to lacunae and imprecisions to be avoided.

Apart from such technical drafting problems, the Working Group encountered a certain number of questions of substance. These problems, namely the relationship between the *force majeure* clause, the domestic law applicable to the contract and the *lex mercatoria,* the very concept of *force majeure* and its relationship to hardship situations and to exemption of liability clauses, as well as the effects of *force majeure,* will be described *seriatim,* before setting out the reasons for which the Working Group considered it inappropriate to propose a standard clause.[24]

A. *Force Majeure* and the Applicable Law

The interest in stipulating a *force majeure* clause in an international contract must be seen in comparison to the solution that would derive from the applicable law in the absence of such a clause.

The romanistic law concept of *force majeure* has not been accepted in all legal systems. Whereas the concept appears undoubtedly to form part of legal systems such as the French[25] and the Belgian,[26] the

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[24] The first French edition of this chapter contained further developments on certain peculiarities of *force majeure* in East-West contracts (*Droit des contrats internationaux,* 1989, pp. 242–244). Such developments have lost most of their interest and they have not been included in the present edition.

[25] Cf. P.H. Antonmattei, *Contribution à l'étude de la force majeure,* Paris, L.G.D.J., 1992; G. Viney & P. Jourdain, *Les conditions de la responsabilité,* Paris, 2nd ed., 1998, pp. 230–253; B. Nicholas, Force Majeure in French Law, in *Force majeure and Frustration of Contract,* E. McKendrick (ed.), L.L.P., 1995, pp. 21–31.

[26] Cf. H. De Page, *Traité élémentaire de droit civil belge,* 3rd ed. II, No. 599; S. Stijns, P. Wery & D. Van Gerven, Chronique de jurisprudence: Les Obligations (1985–1995), *Journ. Trib.,* 1996, pp. 726–728.

On that matter, Socialist legal systems were close to romanistic systems, but there were distinctions to be made between national relationships (sub-distinguishing contracts between enterprises in charge of performing the Plan and other contracts), and foreign trade operations (sub-distinguishing between contracts with other Comecon countries and contracts with free market enterprises) (cf. J. Rajski, Basic Principles of International Trade Law of Certain European Socialist States and of East-West Trade Relations, *D.P.C.I.,* 1978, pp. 9–28).

German[27] and the Italian[28] legal systems prefer to construct analogous regimes around the concept of "impossibility of performance," which is not attributable to the party under the obligation. As for English law,[29] it is radically different from Continental legal systems, since it does not recognize the principle according to which impossibility of performance discharges the debtor; the doctrine of "frustration" sometimes operates to attenuate this, but it considers the problem from a very different angle. American law starts from the same ground, but it also applies the doctrine of "impracticability."[30]

The impact of a *force majeure* clause may appear to be more significant when the applicable law does not recognize the principle of exempting the obligor in the concerned circumstances. Such clauses do, however, exist in most contracts, whatever the applicable law may be. It has been shown that under a legal system that knows the above principle, practitioners still feel the need to re-formulate the conditions, and mainly the effects of such events.

The problem is then whether the rules, which have been discarded, are not mandatory or do not have a public policy dimension (or, in any event,

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A concept of *force majeure* has also developed in European law. Cf. Article 4, 6° al. 2 (ii) of the directive of June 13, 1990 on package travel (*Journ. Off.*, June 23 1990, L. 158/59), as well as M. Parker, Force majeure in EU Law, in *Force majeure and Frustration of Contract*, E. McKendrick (ed.), L.L.P., 1995, pp. 333–353 and the case law referred to.

27 Cf. *Münchener Kommentar, Bürgerliches Gesetzbuch, Schuldrecht, Allgemeiner Teil*, 3rd ed., 1994, pp. 661–808.

28 Cf G. Cian & A. Trabucchi, *Commentario breve al Codice civile*, 4th ed., Padoue, 1999, pp. 1336–1338.

29 Cf. Cheshire Fifoot & Furmston's *Law of Contract*, 13th ed., 1996, pp. 582–605; G. Treitel, *Frustration and Force Majeure*, Londres, 1994.

30 Cf. E.A. Farnsworth, *Contracts*, 1999, pp. 637–667.

We shall not attempt here to undertake an in-depth comparative analysis of different national legal systems in this field. For such an analysis, see, in particular, C.M. Schmithoff, Frustration of International Contracts of Sale in English and Comparative Law, in Problèmes de l'inexécution et de la force majeure dans les contrats de vente internationale, *Assoc. Int. Sc. Jur.*, Helsinki, 1961, pp. 127–158; P. Van Ommeslaghe, Les clauses de force majeure et d'imprévision (hardship) dans les contrats internationaux, *Rev. Dr. Int. Dr. Comp.*, 1980, pp. 1–59 (especially pp. 13–41); J. Gesang, *Force majeure und ähnliche Entlastungsgründe im Rahmen der Lieferungsverträge von Gattungsware*, Königstein, 1980, 230 pp.; D. Rivkin, Lex mercatoria and Force Majeure, in *Transnational Rules in International Commercial Arbitration*, E. Gaillard (ed.), Paris, C.C.I., 1993, pp. 161–208; U. Draetta, Force Majeure Clauses in International Trade Practice, *I.B.L.J.*, 1996, pp. 547–549; P. Pichonnaz, *Impossibilité et exorbitance*, Fribourg (Switzerland), 1997, 437 pp.; K. Zweigert & H. Kötz, *An Introduction to Comparative Law*, 3rd ed., 1998, pp. 516–536; A.J. Goedmakers, *Overmacht bij overeenkomst en onrechtmatige daad*, thesis Rotterdam, 1998, 437 pp.; H. Beale, Partial and Temporary Impossibility in English and French Law, in *Mélanges en l'honneur de Denis Tallon*, Paris, 1999, pp. 219–232.

an international public policy dimension).[31] It seems that, generally speaking,[32] at least as far as the legal systems of European countries are concerned, the rules governing causes excusing performance not attributable to the obligor are not mandatory. This legitimates *force majeure* clauses included in contracts governed by *common law*, or in contracts subject to Continental legal systems that relax the conditions having to be met for the events under consideration, or laying down detailed rules as regards their effects (notice, evidence, suspension, renegotiation, etc.). We would also recall the example cited above in which the parties had borrowed their concept of *force majeure* from a legal system other than the one governing the contract, and repeat our warning against the dangers of "*dépeçage*."[33]

B. *Force Majeure* and *Lex Mercatoria*

Analyzing contractual practice demonstrates the existence of similar international usages concerning the drafting of *force majeure* clauses.[34] While not all *force majeure* clauses are drafted the same way, a certain number of characteristics appear with significant frequency: a less stringent concept of the conditions required for *force majeure*, the effect the events may have of suspending and not extinguishing the obligations, the obligations to inform, to provide evidence and to use all available means to remove obstacles, possible renegotiation after a fixed time limit. In all these respects, clauses arising out of international practice have undeniable similarities, and at the same time they often diverge from the ordinary legal solutions under the various national laws.

Moreover, international contracts, which make no particular stipulation and leave these matters entirely to the applicable national law, are very rare.

Compared with the diversity of national legal systems, the practice in international contracts has engendered characteristic usages, enshrined in contractual clauses, to govern the occurrence of events that prevent performance of obligations. This finding contributes greatly to the debates on the contents of the so-called *lex mercatoria*.[35] Apart from the contracts or

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[31] Cf. B.Mercadal, Ordre public et contrat international, *D.P.C.I.*, 1977, pp. 457–468; Chronique *D.P.C.I.*, 1978, pp. 576–581.

[32] Specific regulations in the sphere of, *inter alia*, international transport law, are exceptions to this principle (cf. for example combined Articles 17 and 41 of the C.M.R.).

[33] Cf. *supra*, p. 407.

[34] For this view, already see C.L. Schmithoff, *op. cit.*, p. 150; G.R.Delaume, *op. cit.*, pp. 262 et seq.

[35] We will not attempt here to fully list the very abundant bibliography on *lex mercatoria* and to discuss the many controversies surrounding the concept. Recent presentations, with many references, are to be found in F. De Ly, *De lex mercatoria, Inleiding op de studie van het transnationaal handelsrecht*, Antwerp and Appeldoorn, 1989, 389 + LXV

standard clauses prepared by trade associations or international institutions (such as the Incoterms published by the ICC), usages have also developed in a spontaneous way around negotiating tables.

The phenomenon is verified by most of the clauses analyzed in the present volume, but *force majeure* clauses provide one of the best demonstrations. They offer a strong specificity that sets them apart from all domestic solutions.[36]

C. *Force Majeure*, Hardship and Exemption From Liability

1. *Notion*

Force majeure, in the strict civil law sense, is an unforeseeable and unavoidable event, which is beyond the control of the party under the obligation, and makes performance of the obligation absolutely impossible.

Some of the clauses analyzed above referred to such a concept, but in *the majority of cases,* the drafters had substituted a *relaxed concept,* a more "human" and more "reasonable" concept better suited to commercial practices. The relaxation of requirements, as we have seen, may take different forms: a more flexible assessment of unforeseeability, of unavoidability or of impossibility of performance and even, on occasion, the abandonment of one or the other of these conditions (more often than not, this is unforeseeability). Here we see a very marked characteristic of international contracts.

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pp.; *Transnational Rules in International Commercial Arbitration*, E. Gaillard (ed.), Paris, ICC, 1993; cf. also K.P. Berger, The New Law Merchant and the Global Market Place, in *The Practice of Transnational Law*, K.P. Berger (ed.), the Hague, Boston, London, Kluwer 2001, pp. 1–22. U. Draetta recalls that the theory of lex mercatoria was initially formulated around the very concept of *force majeure* (*op. cit.*, p. 547); arbitral awards are especially numerous here (cf. U. Draetta, *id.*, pp. 555–557; Y. Derains, L'impact des crises politiques internationales sur les contrats internationaux et l'arbitrage commercial international, *I.B.L.J.*, 1992, pp. 151–166; U. Draetta, R.B. Lake & V.P. Nanda, *op. cit.*, pp. 100–102; D. Rivkin, *op. cit.*, pp. 201–208; Chr. Bellock, La force majeure et la frustration devant le tribunal des différends irano-américains, *Dr. Prat. Comm. Int.*, 1996, pp. 406–449). We would like to point out that this time the *force majeure* clauses enrich the contents of the lex mercatoria.

[36] In this respect the *force majeure* article found in the Unidroit Principles (Art. 7.1.7) is not fully satisfactory. The suspensive role of force majeure, so apparent in clauses drafted in practice, is not emphasized. No provision is made for renegotiation. The article does not mention any obligation to make efforts to overcome the obstacle. (cf. M. Fontaine, Les dispositions relatives au hardship et à la force majeure, & *Contratti commerciali internazionali e Principi Unidroit*, Giuffrè, 1996, p. 190; U. Draetta, Les clauses de force majeure et de hardship dans les contrats internationaux, *Dir. del Comm. Int.*, 2001, pp. 297–308, *I.B.L.J.*, 2002, pp. 348–351). The very similar Article 8.108 of the Principles of European Contract Law makes the same critical observations.

Given the generally suppletive nature of national laws in this area, the parties are certainly free to adopt, by agreement, a more or less flexible concept of *force majeure* excusing performance, depending on the specific nature of the obligations that are likely to be affected, or even the relative strength of the parties to the negotiations. The important point is for the drafters of clauses to be aware of their options, which does not always seem to be the case.

Analysis of the clauses also highlighted the problems that may arise as a result of the relationship between the definition and the enumeration that frequently accompanies it. Sometimes, the aim of the list is to equate with *force majeure* certain events that do not necessarily have the required characteristics (for example, strikes), and, consequently, to enlarge the fund of causes excusing performance. Sometimes, however, as we have seen, the clause is simply poorly drafted. In this respect, drafters of clauses are advised to be particularly careful to set out the conditions under which the events listed will be considered *force majeure.*

The very principle of using an enumeration is sometimes questioned because of the risk of problems with interpretation, just discussed; in theory, moreover, a good definition should suffice to cover all possible instances. The dominant practice, however, is the opposite. The justification given is, *inter alia,* the desire to be as explicit as possible with regards to the intentions of the parties in apportioning the risks.

2. *Hardship and Exemption From Liability*

Relaxing the requirements may reduce, or even abolish, the distinction that normally exists between *force majeure* clauses and two other types of clause, hardship clauses and clauses excluding liability.

a. Hardship[37]

Hardship and *force majeure* are similar in that the events in question, in both cases, should, in principle, be unforeseeable and unavoidable. However, whereas *force majeure* normally renders a contract *impossible* to perform, the incidence of hardship merely makes it substantially *more difficult* for one of the parties. The balance of the contract is upset, but it remains possible to perform it.

That difference, which is clear in theory, is rather blurred where the *force majeure* clause relaxes the traditional requirements justifying impossibility of performance. Above, we cited certain examples of wording such as

[37] On hardship clauses, see *infra,* Chapter 9.

"... des causes ... qui pourraient mettre obstacle à la marche normale de l'approvisionnement, de la fabrication ou des expéditions des contractants" or

"... any cause beyond its control making it impossible or *exorbitant from an industrial or commercial standpoint* to perform its obligations."

Freedom of contract seems to permit such slippage from one concept to the other. However, it is important, yet again, for drafters of clauses to be aware of the problem. It is also important to adapt the regime properly to the hypothesis. The effects normally attached to circumstances of hardship are not the same as the consequences of *force majeure*. For the one, emphasis is placed at the outset on re-negotiation of the contract (it is still possible to perform the contract, but under different conditions if balance is to be restored). For the other, the question of suspending the obligations arises initially (as it has become temporarily impossible to perform them, but when the obstacle has been removed, the contracting parties will find themselves once again in the original circumstances), and re-negotiation should only be considered in the event of prolonged impossibility. If the alleged *force majeure* clause mutates in the event into a hardship clause, it may perhaps be appropriate to examine whether the usual consequences of *force majeure* can be maintained. Will it not be appropriate, for example, to consider immediate renegotiation, not preceded by a longer or shorter period of suspension?

Another problem is having both a *force majeure* clause and a hardship clause in the same contract. It goes without saying that those two clauses should be drafted in a perfectly coordinated manner, and that the relationship between them must be very precise, especially if the conditions for *force majeure* are relaxed as regards impossibility of performance.[38] An interesting system is to merge the two hypotheses into the same provision, while distinguishing them. This could facilitate the understanding of their respective scopes:

"Force majeure and undue hardship

"9.1. The Manufacturer shall not be held responsible to the buyer for any failure to perform, including late delivery or failure to deliver, which failure to perform is caused by occurences beyond the Manufacturer's reasonable control, including, but not limited to, late delivery or non-delivery of manufacturing materials by suppliers, strikes or other industrial action, suspension of or difficulties in transportation.

[38] On that matter, cf. M. Marmusztcyn, *op. cit.*, pp. 803–804.

"9.2. In the event that, due to any reason which was not foreseeable at the time the contract was entered into, and which reason is such as to render the Manufacturer's obligations excessively onerous in relation to the contractual obligations originally agreed upon and, in any event, is such as to increase the Manufacturer's obligations by more than 20 % (twenty percent) compared to the value of such obligations as originally foreseen, then the Manufacturer shall be entitled to request an appropriate revision of the contractual terms or, in the event that the parties are unable to reach an agreement as regards such a revision, the Manufacturer may terminate the contract."

However, there is a tendency to confuse the two notions, with clauses giving the same regime in both cases of impossibility of performance and increased difficulty.[39] This method can be dangerous, because imprecise or ambiguous drafting creates the risk of raising problems of interpretation as to the conditions of implementation.

Practitioners do not always follow abstract logic. In a remarkable presentation at the colloquium organized in Paris to celebrate the 25th anniversary of the Working Group, Professor Draetta mentioned *project financing* operations, where risks are allocated according to the relative bargaining powers. Banks, whose intervention is necessary to the viability of the project, are able to dictate their terms. They cannot accept that reimbursement of the loans could be affected by the normal consequences of *force majeure* or hardship (suspension, termination or re-negotiation of the contract). Irrespective of which kind of disruptive event occurs, banks demand full protection. Risks are exclusively distributed between the other parties.[40]

b. Exemption of Liability[41]

The *force majeure clause* is different in principle from a *clause excluding liability:* in theory, a *force majeure* event, which is beyond the control of the obligor, does not entail his liability.[42] The *force majeure* clause governs circumstances that exclude *per se* any liability: its purpose is not to exclude by

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[39] Cf. *supra*, pp. 405–406.

[40] U. Draetta similarly refers to the antitrust risk in contracts for the purchase of companies, as well as to the risk of change of control in joint ventures (U. Draetta, Les clauses de force majeure et de hardship dans les contrats internationaux, *Dir. del Comm. Int.*, pp. 303–307, *I.B.L.J.*, 2002, pp. 352–357).

[41] On clauses excluding or limiting liability, cf. *supra*, Chapter 7.

[42] In any event, that is the general position in legal systems which recognize the concept of *force majeure* or an equivalent regime. Even in those systems, however, the person upon whom certain obligations are incumbent may have to answer for the *force majeure* (*obligations de garantie*).

agreement liability that would otherwise be incurred. That is why the majority of *force majeure* clauses, as we have seen, do not consider it necessary to confirm explicitly the absence of liability on the part of the party under the obligation.

However the distinction becomes less clear-cut where the clause relaxes the strict requirements of the concept of *force majeure* to the extent of taking into consideration events that are foreseeable or avoidable. When an obligor is no longer liable for non-performance due to events that were foreseeable, or to obstacles that he could have avoided, the *force majeure* clause plays the same role as an exemption clause. With such an extensive clause, the obligor transfers to the other party certain risks that he normally should have borne and which would have entailed his liability.

Therefore, such relaxation of the requirements, whether they result from a broad definition of *force majeure* or from the occurrence of certain unqualified events in the enumeration, may partially transform the *force majeure* clause into a clause excluding liability. That is the case, for example, when the clause excludes the liability of the obligor in any case of fire, even those that could have been avoided.[43]

There are, however, certain limits to freedom of contract. Clauses, which exclude or restrict liability, are generally not accepted by legislation without reservation. In French law, for example, they cannot exempt a party from fraud nor from gross negligence.[44] A clause based on too lax a concept of *force majeure* runs the risk of becoming ineffective when invoked in certain circumstances.

D. Effects

1. Exemption and Suspension

According to the classical theory, *force majeure* discharges the party under the obligation, without liability.[45] The practice in international contracts confirms this *effect force majeure* has of *excusing performance,* but it pushes the extinguishing effect into a secondary role, and replaces it with a *suspensory effect* in the primary role.

Most international contracts incorporate a time dimension; they provide for obligations to be performed continuously or successively. Yet, in general, *force majeure* events occur only for a certain time, after which per-

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[43] Cf. *supra*, pp. 355–356.

[44] Cf. *supra*, pp. 384–385.

[45] Cf. for example, in French law, G. Viney & P. Jourdain, *op. cit.*, p. 246.

formance of the obligations will probably become possible again.[46] As the parties often have a substantial common interest in the survival of the contract, they will stipulate that the obligations affected by *force majeure* will initially only be suspended.[47] The *force majeure* clause is not designed to be a method of avoiding obligations, but is intended to provide the parties with a temporary respite, enabling them to resume normal relations at a later date.[48]

That suspension may be organized in various ways, as seen in the analytical part. It is important, *inter alia*, to determine whether the initial length of the contract is or is not to be extended by the period of suspension.

2. Termination, Re-Negotiation, Adaptation, Winding Up

If impossibility of performance extends beyond a given time, suspension of performance of the contract becomes intolerable, and the parties must take other measures. Here also, it is clear that the aim is to ensure that the contract survives. Although *termination* is provided for in some clauses, it is more often stipulated, particularly in contracts for the construction of units, that the contract is to be *re-negotiated* with a view to its being *adapted*. The *force majeure* clause therefore falls under the category as a revision clause.[49]

The commitment to re-negotiate raises substantial problems, *inter alia*, that of the very validity of such an agreement (particularly in English law), and that of the role of the arbitrator who may be called upon to modify the contract, in the event the parties fail to agree. Those difficulties are also raised, *mutatis mutandis*, in the chapters concerning letters of intent,[50] hardship clauses[51] and first refusal and most-favored customer clauses.[52]

In the event of termination of the contract, the problem of the *winding up* of contractual relations arises. We have seen above how certain *force majeure* clauses deal with this, and pointed out the developments in recent contracts.

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[46] The position is different for short-term contracts, for example certain freight forwarding contracts.

[47] The classical theory generally also confers a suspensive effect on temporary impossibility of performance, but that hypothesis is presented as a special case which is something of an exception. The exception becomes the rule in long-term international contracts.

[48] G.R. Delaume, *op. cit.*, p. 244.

[49] Cf. already Ph. Kahn, *op. cit.*, p. 468, as well as G.R. Delaume, *op. cit.*, p. 259.

[50] Cf. *supra*, Chapter 1.

[51] Cf. *infra*, Chapter 9.

[52] Cf. *infra*, Chapter 10.

3. *New Obligations*

Another aspect of the contractual effects of *force majeure* emerges particularly from the group's proceedings: the occurrence of the events considered *causes* the parties, or one of them, to incur *new obligations*.

First of all, the other contracting party must be *notified* of the *force majeure*, and it must be provided with appropriate *evidence*. Then, the clause imposes on the parties the task of *striving to remove the obstacle of force majeure*. That obligation, which also reflects the desire to ensure that the contract survives, is consistent with the view that the obstacle is in principle considered to be temporary and as entailing only a provisional suspension of the obligations affected. Another obligation sometimes provided for is that of *giving notice of the end of the force majeure*.

Yet again we can see, in relation to the effects of *force majeure*, the exceptional richness of the law created by contractual practice, which is in sharp contrast to the over-simplification of the classical theory.

E. A Standard *Force Majeure* Clause?

Several participants in the Working Group mentioned the advantages of a standard *force majeure* clause. The analysis of the clauses found, in practice, showed the poor quality of much of the drafting: imprecision, ambiguities, lacunae.

Admittedly, some carefully crafted standard clauses are already available to practitioners. They are, in general, *force majeure* provisions included in standard contracts of large diffusion, for example, in the General Conditions drawn up by the U.N. Economic Commission for Europe[53] or in the new FIDIC contracts.[54] One also knows the standard *force majeure* clause prepared by the International Chamber of Commerce, in its recent new edition.[55]

Could the Working Group not also, in its turn, propose a standard clause?

1. *Arguments Against Drafting a Model* Force Majeure *Clause*

That task was not undertaken for several reasons.

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[53] Cf. other examples in K.H. Böckstiegel, *op. cit.*, as well as in U. Draetta, Force Majeure Clauses in International Trade Practice, *I.B.L.J.*, 1996, pp. 553–554.

[54] Cf. Chr. R. Seppala, FIDIC's New Standard Forms of Contract: Risks, Force Majeure and Termination, *I.B.L.J.*, 2000, pp. 1013–1025.

[55] *I.C.C. Force Majeure Clause 2003 and ICC Hardship Clause 2003*, Paris, ICC, 2003.

First, the concept of *force majeure* may be interpreted in various, more or less strict ways, and the drafting of a clause depends obviously on the parties' wishes. There is a whole spectrum of ways in which the conditions for *force majeure* may be relaxed.[56] In addition, the other elements of the clause may also need appropriate drafting in order to adapt to the case in point, for example, methods of giving notice and of providing evidence, the length of time of the suspension, possible solutions if the *force majeure* events persist, etc.[57]

Instead of proposing one or two standard clauses, it appeared to us that it would be more useful to provide practitioners with an inventory of different aspects of a *force majeure* clause together with an indication of the possible variations and the necessary *caveats.* That was the principal object of the first part of this review. Each drafter should take from it the appropriate materials to construct himself the clause which would best suit his contract.[58]

A second reason is linked to a pretty fundamental observation, which the majority of negotiators do not yet seem aware of. In a great majority of cases, it seems that contracts contain only one *force majeure* clause, which is intended to govern the non-performance of any obligation. Yet, all the obligations arising from a contract are not necessarily affected in the same way by the occurrence of a *force majeure* event. The payment of the purchase price by the buyer, for example, is more rarely rendered impossible than the supplying of the goods by the seller.[59] That observation leads to the suggestion that a well-drafted contract should not contain only one *force majeure* clause, but several, and possibly as many as there are obligations, each one to be treated according to its specific nature.

Such a desire for perfection could admittedly lead to excessively complicated negotiations and to overly ponderous contracts. But, within reasonable limits, negotiators should consider whether certain obligations should not be made subject to a particular regime as far as *force majeure* is concerned.

Another argument against the drafting of a single standard clause is that the wording of the clause (or clauses) must also take account of the specific nature of each contract, and maybe even of each of the contract-

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[56] Cf. *supra*, pp. 403–406.

[57] Cf. *supra*, pp. 418–439.

[58] Such was also the approach taken by UNCITRAL in its *Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works,* New York, 1988, pp. 233–240 (exemption clauses).

[59] Cf. *supra*, pp. 436–437.

ing parties. For example, the risk of ice would not be included in a contract that was to be performed below the equator, but that possibility does deserve particular mention if the supplies are to come from Finland or Canada. Problems in supplying raw materials are relevant to a contract for the supply of goods but not to an agreement relating to the delivery of intellectual services. The period of suspension of obligations is a function of how tolerable that is for the parties, taking account of whether punctual performance of the contract is more or less important. *Fait du prince* has a specific relevance when the State itself is one of the contracting parties. We have seen contracts that, in a very adequate way, had different provisions for the respective parties, especially concerning circumstances excluded from the notion of *force majeure*[60] and the consequences of the occurrence of a *force majeure* event.[61]

For these different reasons, the Group is not proposing a standard *force majeure* clause. However, the analytical section of the review contains the principal sources of inspiration, which may be useful in the drafting of clauses adapted to the special needs of the contract.[62]

2. *The Expression* Force Majeure

As regards *terminology*, is it appropriate to recommend the use of the expression *force majeure* clause?

There are two arguments for not doing so. First, the concept of *force majeure* is not recognized in all legal systems. If the contract is governed by a legal system, which does not cover this concept, the expression may lead to confusion.[63] Secondly, even if the applicable law does recognize the concept of *force majeure*, numerous clauses are designed to relax its requirements and consequently to change its nature.

When the first edition of this chapter was drafted, several codifications regarding international trade, which were then recent, had abandoned any reference to the expression *force majeure*. The Comecon General Conditions referred to "circumstances constituting an insurmountable force" (Section 68). The Geneva Conditions, in particular those relating to the supply of equipment, mention "causes excusing performance" (Article 10). The Vienna Convention on the International Sales of Goods deals with the subject (Article 79) under the title "Exemptions."

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60 Cf. *supra*, pp. 416–418.

61 Cf. *supra*, pp. 438–439.

62 B.J. Cartoon, Drafting an Acceptable Force Majeure Clause, *Journ. of Business Law*, 1978, p. 232, is also reluctant towards drafting standard *force majeure* clauses.

63 L. Kopelmanas described the concept of force majeure as a "fausse idée claire" (something which only seems self-evident) (*op. cit.*, p. 305).

Some of the members of the Working Group proposed to following the same route when drafting clauses.

Other participants had stressed the extent to which the expression *force majeure* is anchored in international customs, even if its content varies; they wondered whether it would be wise to use other expressions that may cause even more confusion. It is true that most of the clauses in our sample used the words *force majeure.*

Important new developments have caused the concept of *force majeure* to be recognized as a concept at the international level. The Unidroit Principles have entitled their Article 7.1.7 *force majeure,* in the English version as well as the French one.[64] The new FIDIC contracts have abandoned the expression "special risks" of earlier editions; clause 19 is now called *force majeure* (in French).[65]

The essential point is to agree on the meaning of the words used. If the expression *force majeure* retains the support of negotiators, they are advised to specify its scope clearly.

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[64] Corresponding expressions are used in the Italian (*forza maggiore*), Spanish (*fuerza mayor*) and Portuguese (*força maior*) versions, and even in the Russian version (where *fors major* accompanies the expression *nepreodolimaia sila*). The German version has translated *force majeure* into *Höhere Gewalt.*

[65] Cf. Chr. R. Seppala, *op. cit.*, pp. 1019–1021.

CHAPTER 9
HARDSHIP CLAUSES

I. INTRODUCTION

A. Sanctity of Contracts and Substantial Change of Circumstances

When parties enter a contract, they bind each other to create a situation on which they can legally rely. The principle of sanctity of contracts makes each other's undertakings enforceable. The firm, which has a contract with a supplier, knows that the goods will be made available in due time (or that it will be indemnified in case the supplier fails to perform), and the supplier can rely on the buyer to pay the price.

However, each party accepts to be bound, under the circumstances prevailing at the time when the contract is executed. The goods are bought because the buyer can use them within his scope of activity; the price is set by reference to the current value of the goods.

It can happen, especially in long-term contracts, that such circumstances change, sometimes substantially, when performance has to take place. The goods to be delivered have lost all utility, because of a change in technology, because certain markets are now inaccessible for political reasons or because some new regulation prohibits their use. Because of a strong inflation or of a crisis in the currency exchange market, the agreed price now corresponds only to a small part of the value of the goods. Under such conditions, should the contract still be performed such as it is? Is sanctity of contract an absolutely inflexible principle? Is it not conceivable to re-adapt the contract, or to terminate it?

B. Solutions in Comparative Law

The issues are known to each legal system, but answers vary.[1]

[1] Only a brief synthesis will be presented here. For a thorough discusssion, cf. D. Philippe, *Changement de circonstances et bouleversement de l'économie contractuelle*, Brussels, Bruylant, 1986, 714 pp. Cf. also C.M. Schmithoff, Frustration of International Contracts of Sale in English and Comparative Law, in *Problèmes de l'inexécution et de la force majeure dans les contrats de vente internationale*, Assoc. Int. Sc. Jur., Helsinki, 1961, pp. 127–158; H. Lesguillons, Frustration, force majeure, imprévision, Wegfall der Geschäftsgrundlage, *Dr. Prat. Comm. Int.*, 1979, pp. 507–532; P. Van Ommeslaghe, Les clauses de force majeure et d'imprévision (hardship) dans les contrats internationaux, *Rev. Dr. Int. Dr. Comp.*, 1980, pp. 1–59 (especially pp. 13–41); H. Van Houtte, Changed circumstances and *pacta sunt servanda*, in *Transnational Rules in International Commercial Arbitration*, E.

In France and in Belgium, the problems are examined under the theory of *imprévision,* applicable only if the change of circumstances leads to unbalanced obligations. In both countries, courts refuse, in principle, to re-adapt the contract, except in French administrative case law or under particular legislation.

Elsewhere, approaches are less restrictive. In many other legal systems, statutory provisions or judicial interpretations allow a court either to terminate the contract or to adapt it, when circumstances are substantially changed. Statutory provisions are found, e.g., in Greece (Civil Code, Article 388), Italy (Codice Civile, Article 1467), the Netherlands (N.B.W., Article 6-259) and Russia (Civil Code, Article 451). On the other hand, significant case law solutions have developed in countries such as Germany (theory of *Wegfall der Geschäftsgrundlage,* related to the principle of *Treu und Glauben*), Switzerland (several legal bases, including the very interesting "mistake on future circumstances") or Italy (with the concept of *presupposizione*). In England, courts have developed the *doctrine of frustration,* partly through the famous *Coronation* cases (what was to be done with the balconies rented along the route of the procession due to take place for the coronation of King Edward VII, after the ceremony was cancelled?). The concept of *frustration* also belongs to American law, where one finds the notion of *impracticability,* based in the Uniform Commercial Code (Article 2, Section 615a) and retained by the *Restatement Second on Contracts* (Section 261).

Comparative law reveals the unduly restrictive approach of French and Belgian law. *Imprévision* concerns cases in which performance of the contract has become excessively onerous for one party; the same approach is found in Article 1467 of the Italian Codice Civile (*eccessiva onerosità*). But the issue is often broader; it also includes situations in which the change of circumstances deprives the contract of all economic utility for one party, without necessarily rendering the respective obligations unbalanced (cf. a contract for the supply of some raw material, which the buyer cannot use any more due to a technological change). Such is the approach of the German notion of *Wegfall der Geschäftsgrundlage* (disappearance of the contract foundations), of the Italian *presupposizione,* of *frustration* and *impracticability* under the *common law* (the *Restatement Second* refers to "*the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made*"). The Dutch N.B.W. uses a very broad formula: Article 6-259 concerns the occurrence of unforeseen circumstances "*of such a nature that under the criteria of reason and equity, the other party cannot expect that the contract remains fully unchanged.*"

Gaillard (ed.), Paris, ICC, 1993, pp. 105–123; M. Prado, La théorie du *hardship* dans les Principes de l'Unidroit relatifs aux contrats du commerce international, *Dir. del Comm. Int.*, 1997, pp. 323–373; K. Zweigert & H. Kötz, *An Introduction to Comparative Law*, 3rd ed., 1998, pp. 516–536.

A great variety of solutions appears. Substantial change of circumstances is generally taken into consideration, but not always. When it is, the legal basis may be a statute or case law. Each legal system takes its position: either in favor of the narrow approach of excessively onerous performance or of the broader notion of disappearance of the foundations of the contract. Original concepts have developed in the different jurisdictions. Remedies offered may be adaptation of the contract, or its termination, or a combination of both, with different variations.

C. Hardship Clauses

The above explanations can be a source of concern for drafters of international contracts. A middle or long-term undertaking runs the risk of being subject to a change of circumstances. If the applicable law, such as French or Belgian law, gives absolute prominence to the principle of sanctity of contracts, a party may find itself bound by obligations that will have become unbearable, or by a contract that will have lost its economic purpose. In the more numerous cases, where the applicable law permits the contract to be reconsidered, it is up to a court to evaluate the situation, and the remedies available are not necessarily adequate. For instance, if the law provides only for termination of the contract, this will often be considered an excessively radical solution.

Hardship clauses have appeared in this context. They organize the review of the contract when changed circumstances have deeply altered the economy of the operation.[2]

A long-term supply contract requires a minimum number of deliveries. An economic crisis intervenes, creating a set of circumstances completely different from the one originally envisaged by the parties. The purchaser is compelled to reduce his production by a substantial amount. By invoking the hardship clause, he obtains the agreement of his co-contractor on the reduction of the agreed minimum.

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[2] On hardship clauses, cf. also B. Oppetit, L'adaptation des contrats internationaux aux changements de circonstances: la clause de "hardship," *Clunet*, 1974, pp. 794–814; J.H. Dalhuisen, De betekenis van de "hardship" clausule, *Ned. Jurist. Blad*, 1976, pp. 173–184; P. Van Ommeslaghe, Les clauses de force majeure et d'imprévision (hardship) dans les contrats internationaux, *Rev. Dr. Int. Dr. Comp.*, 1980, pp. 1–59; U. Draetta, R.B. Lake & V.P. Nanda, *Breach and Adaptation of International Contracts*, Salem, 1992, pp. 191–198; P. Moisan, Technique contractuelle et gestion des risques dans les contrats internationaux: les cas de force majeure et d'imprévision, 35 *Les Cahiers de Droit* (1994), pp. 281–334; W. Den Haerynck, Drafting Hardship Clauses in International Contracts, in *Structuring International Contracts*, D. Campbell ed., Kluwer, 1996, pp. 231–242; J.M. Mousseron, *Technique contractuelle*, Paris, 2nd ed., 1999, No. 1655–1681; U. Draetta, Les clauses de force majeure et de hardship dans les contrats internationaux, *Dir. del Comm. Int.*, 2001, pp. 297–308, *I.B.L.J.*, 2002, pp. 347–358; H. Konarski, Force majeure and hardship clauses in international contractual practice, *I.B.L.J.*, 2003, pp. 405–428; M. Prado, *Le hardship dans le droit du commerce international*, Brussels and Paris, 2003.

Another contract contains a price review clause, one of whose parameters refers to quotations for certain oil products. The disruption of the oil market completely upsets this formula for conversion. The hardship clause contained in the contract enables the re-negotiation of the formula for review.

These two examples demonstrate the role that hardship clauses can fulfill in circumstances characterized by the extreme volatility of the economic situation.

The term "hardship" is frequently employed, in practice, to describe the clause in question, even in contracts drafted in other languages than English. The Unidroit Principles on international commercial contracts have also retained the term "hardship" not only in the English version, but also in the French, Italian, Spanish and Portuguese editions, as title of the chapter dealing with change of circumstances (Articles 6.2.1 to 6.2.3).[3]

D. Hardship and *Force Majeure*

The substantial change of circumstances, which the typical hardship clause encounters, is connected with the occurrence of events that upset the economics of a contract, with the result that its performance becomes unusually onerous or devoid of purpose for one of the parties, but without rendering such performance impossible. On the other hand, for *force majeure,* there has to be an event that totally prevents the performance of the contract, whether temporarily or permanently. Whereas the change of circumstances may lead to the amendment or termination of the contract, *force majeure* brings about its suspension (in the event of temporary impossibility) or termination (in the event of complete impossibility). The common link between the two concepts is the occurrence of unforeseeable and unavoidable events.

The difference between change of circumstances and *force majeure* is clear-cut on the theorical level, but, in practice, it is often the case that *force majeure* is contractually defined in a way that weakens the requirement of impossibility of performance. *Force majeure* and hardship clauses then tend to deal with similar situations, but the consequences may remain different (a *force majeure* clause will stress suspension of the obligations, while a hardship clause will be centered on re-negotiation). However, there is a tendency to integrate the two notions in clauses covering both hypotheses.

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[3] The title becomes "*Änderung der Geschäftsgrundlage*" in German. In the Spanish version, "*excesiva onerosidad*" is used as a synonym. On these provisions of the Unidroit Principles, cf. *infra*, p. 488.

Such interferences have already been examined—with certain warnings—in the chapter dealing with *force majeure* clauses, which has also discussed the possible coexistence of both clauses in the same contract.[4]

E. Hardship and "*Sujétions Imprévues*"

Civil engineering contracts often provide for the situation where unexpected difficulties, for example, regarding the nature of the soil, become apparent during the course of the performance of the contract. Various remedies are possible, in particular the re-negotiation of the contract or the complete assumption of these risks by the contractor. In the absence of any clause, the French administrative law theory, known as *sujétions imprévues*, can give the contractor the right to an indemnity if he is nevertheless obliged to perform the contract. Apart from the fact that the application of this theory is limited to public works and supply contracts, the difference between *sujétions imprévues* and *imprévision* lies, in principle, in the fact that the cause for the former exists prior to the contract.[5]

F. Hardship Clauses, Index Clauses, Review Clauses, Exchange Clauses, Adaptation Clauses, Etc.

Apart from hardship clauses, there are various types of clauses enabling the amendment of the contractual conditions in certain defined circumstances, for example, in the event of variation of the costs, prices, salaries, exchange rates, or when one of the parties finds itself able to contract on more favorable terms with a third party (most favored client clause) or receives a more favorable offer from a competitor, etc. Such clauses differ from hardship clauses inasmuch as they provide for the modification of the original circumstances based on the occurrence of well-specified events (and not, for example, as result of "any unforeseen upsetting of the economic circumstances"). Consequently the effect on the contract can often be pre-arranged: immediate indexation, adjustment of exchange rate, alignment on more favorable conditions offered to third parties, etc. (whereas the circumstances in a hardship clause are such that they do not enable prior arrangements for amendment; re-negotiations will be required).

But the distinction is not absolute. On the one hand, certain clauses, known as most-favored client clauses, provide for a re-negotiation on the basis of the conditions offered to third parties, not an automatic realignment.[6] As far as monetary changes are concerned, apart from clauses providing for indexation or automatic re-adjustment, there are likewise review

[4] Cf. *supra*, pp. 443–445.

[5] On *sujétions imprévues* in French law, cf. R. Chapus, *Droit administratif général*, Paris, 12th ed., 1999, pp. 597–599.

[6] On the last two types of clauses, cf. *infra*, Chapter 10.

clauses that call for a re-negotiation of the contractual conditions. As will be seen, certain hardship clauses are very specific as to the circumstances in question.

Hardship clauses and other clauses (including force majeure) can be complementary, for example, when unexpected events completely alter the effect of an index clause. It is worth providing simultaneously for the different types of clause, since they can be used either separately or together according to the circumstances.

G. Hardship Clauses and Safeguard Clauses

In French, the expression *clause de sauvegarde* is sometimes used as a translation for hardship clause, but this can create confusion. Safeguard clauses in public international law are those that enable a party to waive, temporarily, some or all of the provisions of a treaty, owing to momentary difficulties, which need not necessarily have the characteristics of unavoidability and unforeseeability, common to *force majeure* and *imprévision*.[7]

II. PRACTICE

A. General Observations

Are hardship clauses frequently inserted in international contracts? Have these clauses existed for a long time, or is their appearance recent? Are they becoming more frequent? Are they especially linked with certain sectors of the economy? To certain types of contracts? Who takes the initiative in proposing their insertion? Are they avoided in dealings with certain partners?

First of all, it seems that hardship clauses have been used in international contracts in earlier troubled periods of the 20th century, but that their insertion seems to have multiplied greatly in the 1970s. The lack of certainty ensuing from the upsetting of the international economic and monetary system, as well as the petroleum crises, help explain this phenomenon. The rapid increase in the recourse to hardship clauses was, at first, well reflected in their drafting: from a very simple structure and general composition, some of these clauses, within a few years, had reached an impressive degree of elaboration.

In the more recent past, hardship clauses seem to have attained a certain state of stabilization. While different features of *force majeure* clauses went through a marked evolution since the first French edition of this book,[8] the

[7] Cf. A. Manin, A propos des clauses de sauvegarde, *Rev. Trim. Dr. Eur.*, 1970, pp. 1–42, and especially pp. 7–12.

[8] Cf. *supra*, pp. 400–401.

new hardship clauses gathered by the Group revealed few innovations. The tendency to increased sophistication seems to have slowed down.

Long-term contracts are clearly those where hardship clauses are most frequently stipulated, since operations due to be performed over a long period of time are more vulnerable to modified circumstances.[9]

The sectors of the economy, where hardship clauses appear to be sometimes or often provided for, are notably those of large works projects, the petroleum industry, chemicals, iron and steel, non-ferrous metals, mechanical engineering, data processing (where technological modifications are especially significant) and banking (international loans). Particular characteristics of the clauses used correspond to the diversity of the sectors they cover; these will be pointed out in the following analysis.

Putting hardship clauses into effect gives rise to problems of interpretation of considerable delicacy and requires much in the way of true cooperation between the parties. The insertion of such a clause is therefore easier when the contracting parties belong to the same *milieu*, with the same economic, legal and cultural background, and when, by extension, they have enjoyed good business relations for some time, and wish to preserve them.

By contrast, it is more difficult to include hardship clauses in a contract concluded between partners from different backgrounds, as, for example, in relations between industrial countries and Third World countries. The European party will fear any provision that might threaten the principle of sanctity of contract (or more directly, which might bring about the refusal by the export credit guarantee organization to give cover); but, sometimes, it is the partner from the developing country who, being anxious to secure the full anticipated advantage of the contract, refuses to insert in it a clause likely to produce uncertainty.

The hardship clause may also appear when there is an imbalance of power between the contracting parties: the stronger party can ensure the insertion of such a clause drawn up so as to act unilaterally in its favor.

A few cases were made known where re-negotiation of the contract took place without there being a hardship clause, and without apparently invoking an applicable national law that would provide remedies for change of circumstances. Certain situations can, in fact, compel the partners to maintain their contractual relationship in spite of all difficulties, even when the upsetting events make the adherence to the original provisions impossible. Clearly, amicable re-negotiation is always possible between understanding partners.

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[9] This will be discussed *infra*, pp. 487–488.

B. Critical Analysis of Hardship Clauses

The Working Group was able to proceed to a systematic study of about 50 hardship clauses in the first stage, and about 20 more when updating this review. Before setting out the results of this analysis, the fact should be stressed that not all the hardship clauses include necessarily all the characteristics that will be discussed. Each sector of the economy, each type of contract, each set of partners has its own requirements. The combined analysis should however represent a useful check-list for those responsible for drafting any hardship clause. The degree of sophistication of certain clauses is remarkable, and features introduced in clauses in one particular sector could well be employed, *mutatis mutandis,* in other types of contract.

Hardship clauses always contain two main parts. The first part defines the hypothesis under which the clause will apply. This part itself consists of two elements:

1. certain circumstances, more or less specific, which
2. produce certain consequences in the contractual relationship.

The second part of the clause stipulates the procedure applicable in case the hardship event occurs. This ranges from the simple agreement to re-negotiate the contract, formulated without any further details, to the organization of an extremely complex procedure, involving, in particular, recourse to third parties, arbitrators or experts.

1. *Preamble*

Certain hardship clauses start with a short preamble. Examples:

- "Les droits et obligations résultant de la présente convention déterminent, compte tenu des circonstances, une position relative des parties au moment de la signature."
- "Les dispositions de la présente Convention ont été arrêtées en fonction des données juridiques, fiscales et monétaires, économiques et financières existant à la date de signature de la présente Convention dans les pays où sont situés les sièges sociaux du Prêteur et de l'Emprunteur ou dans le pays tiers par l'intermédiaire duquel des paiements sont effectués ainsi qu'en fonction des conditions économiques et financières internationales à cette même date."
- "In entering into this long term Contract the parties hereto agree that it is impracticable to make provision for every contingency which may arise during the term thereof; and the parties hereby agree it to be their intention that this Contract shall operate

between them with fairness and without prejudice to the interests of either."

The essence of hardship clauses is expressed in these preambles: the notion of unforeseeability (third example), the chronologically relative character of the position of the parties (first and second examples), the spirit inspiring the amendment of the contract, the emphasis being put either on the balance of obligations (second example) or on fairness or equity (third example).

These concepts are not absent from hardship clauses, which do not include a preamble, since they normally appear either expressly or implicitly in the body of the clause. The use of a preamble helps explain the philosophy behind the clause, thereby facilitating its eventual application by a third party, whether arbitrator or expert.[10] One should, however, take good note of the fact that these two examples of preambles already reveal two different criteria that may assist in the amendment of the contract, an "objective" criterion (the balance of obligations) or a "subjective" criterion (fairness, equity).

2. Hypothesis

The first part of every hardship clause defines the situation in which the clause shall apply. First, it is a question of whether certain circumstances occur, and subsequently what consequences on the economics of the contract ensue from these circumstances. In order to clarify the position before proceeding to a more detailed examination, let us cite a simple example where these two aspects of the situation are clearly revealed:

> ". . . si par suite de circonstances d'ordre économique ou commercial survenant après la signature du contrat et en dehors des prévisions normales des parties (*circumstances*) l'économie des rapports contractuels venait à être modifiée au point de rendre préjudiciable pour l'une des parties l'exécution de ses obligations (*consequences*) . . ." [The remainder describing the relevant procedure.]

(a) Circumstances. The clauses examined reveal a great variety of circumstances that have been taken into consideration. A few constant features are nevertheless evident, mainly concerning the ideas of change and unforeseeability and the external nature of these in relation to the control of the parties.

1. *Change in Initial Circumstances.* Hardship clauses concern situations where the initial circumstances surrounding the contract undergo a change. This idea is expressed in many different ways:

[10] Cf. *supra*, chapter 2, pp. 88–90.

- "... Compte tenu de *l'évolution* des circonstances ... "
- "... in the event of a *new* situation ..."
- "... dans les cas où la situation économique ou monétaire subirait des *modifications* ..."
- "... au cas où se produiraient des *variations* très importantes dans la conjoncture ou des *modifications* très notables dans les conditions économiques ... "
- "... Si par suite de circonstances ... *survenant après* la signature du contrat ..."
- "... si les conditions du marché *devenaient telles* que ..."
- "... if there is the occurence of an *intervening event* or *change of circumstances.* ..."

The change of circumstances is of no effect unless it seriously affects the relations between the parties; this will become apparent in examining the consequences.

Sometimes, however, the clause requires that the change in circumstances itself be substantial. One of the examples cited above refers to *variations très importantes* in the circumstances, or to *modifications très notables* in the economic situation. Another clause refers to *circonstances extraordinaires.*

2. *Unforeseeable Change of Circumstances.* A mere change of circumstances is not sufficient; the change of circumstances must also have been *unforeseeable* at the time of the making of the contract. An evolution of circumstances, which was initially foreseeable (and whose consequences on the relationship of the parties could be assessed at the outset) is covered not by hardship clauses but by other types of clauses, for example, by review or index clauses. The very fact that the parties provide for a hardship clause necessarily implies that they are aware of the possibility that the circumstances might be upset in the future. But they are not in a position to provide for the nature, scope or time of such a development.[11]

The hardship clauses examined often take up this idea of unforeseeability. Examples:

- "... des circonstances ... *en dehors des prévisions normales des parties* ..."
- "... en cas de survenance d'événements économiques *imprévisibles* ..."
- "... it is *impracticable to make provision* for every contingency which may arise ..."

Sometimes the hardship clause expressly refers to certain circumstances whose evolution is governed by another provision in the contract, so as to exclude them from the scope of the hardship clause:

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[11] Certain hardship clauses provide for the evolution of very precise circumstances, at least as far as their nature is concerned.

- "... En cas de survenance d'événements économiques imprévisibles ou exclus par les prévisions qu'ont admises acheteur et vendeur—(telles sont notamment les modifications de charges de toutes natures—*autres que celles relevant de l'article 5*—les hausses des matières premières ou autres causes conduisant à une aggravation importante des coûts de fabrication) . . ."

Some clauses limit themselves to requiring that the change in circumstances should be *unforeseen:*

"... des circonstances extraordinaires ou *non prévues* . . ."

Such a formula would appear to be dangerous, since the party who merely lacked foresight has the benefit of re-considering the contract, by not taking into consideration certain events whose occurrence was clearly foreseeable.

Sometimes the criterion of an event beyond the control of the parties is substituted for the criterion of unforeseeability:

- "... an intervening event or change of circumstances *beyond said party's control* when acting as a reasonable and prudent operator . . ."
- "... toutes circonstances *indépendantes de la volonté des parties* . . ."

This last clause specifies that:

"Sont indépendants de la volonté des parties au sens de cette clause, les circonstances qui ne résultent d'une faute de la partie qui les invoque"

The two criteria of unforeseeability and being outside the control of the parties are not interchangeable. They cover two different situations that should, it seems, be applied in a cumulative way. Drafters of such clauses should be aware of this.

Yet numerous clauses do not refer to either of these two criteria:

"... compte tenu de l'évolution des circonstances . . ."

This gap would appear to be dangerous, since it greatly increases the potential scope of the hardship clause.

3. *What Types of Circumstances Are Taken Into Consideration?* The hardship clauses considered show considerable variety in this respect.

(i) Broad Wording. The broadest wording can cover:

"Tous faits qui pourraient mettre en péril la bonne fin du marché."

The strikingly general nature of this phrase must be considered in the light of the fact that this is a unilateral clause making one of the parties *le seul juge de la question.*

There is another example of a clause, which is hardly less far reaching in its scope:

> "If for any *bona fide cause* the revenue accruing to you for this transaction is insufficient to meet the costs . . ."

The following clause of this kind first sets out a list of relatively specific events:

> "Toutes difficultés . . . relatives à l'obtention de devises, à des mesures de politique commerciale, au contingentement, à la manipulation monétaire."

However, it ends the list with the word "*etc.*," thus extending the scope of the clause to infinity. Such a clause is also one whose application is left to the unilateral discretion of one of the parties.

The majority of clauses examined by the Group, however, cover the occurrence of better defined circumstances, either where they are qualified in a general manner, or where it is a question of specific circumstances, or where the clause employs a combination of these last two.

(ii) General Circumstances. The generally worded clauses usually cover the evolution of economic, commercial or monetary circumstances. Examples:

- "Au cas où se produiraient des variations très importantes dans la *conjoncture* ou des modifications très notables dans les conditions *économiques* . . ."
- ". . . en cas de bouleversement du *système monétaire international actuel* . . ."
- "en cas de modification *d'ordre monétaire* . . ."
- ". . . *monetary* events and/or alterations . . ."
- ". . . dans le cas où la situation *économique ou monétaire* subirait des modifications . . ."
- ". . . par suite de circonstances d'ordre *économique ou commercial* . . ."

The clause sometimes also embraces a change in *political circumstances,* especially in the case of contracts concluded with partners from a country judged to be politically unstable:

- ". . . dans le cas de la survenance d'événements *politiques* extérieurs ou intérieurs . . ."

- "dans le cas où un événement grave . . . de caractère *politque, économique ou financier* . . ."

Here are two slightly more specific wordings:

- "la survenance d'événements susceptibles de perturber le fonctionnement normal des institutions financières (du pays X) ou de tout fait pouvant entraver le déroulement ponctuel des paiements extérieurs (du pays X) . . ."
- "Les Parties reconnaissent que, dans le cadre des restructurations en cours de l'industrie européenne de . . . , elles peuvent être amenées à accepter des exceptions aux règles qui précèdent, qu'elles s'engagent à négocier de bonne foi."

Some clauses provide that the events in question can be internal or external, national or international.

Economic, financial, commercial and political circumstances are probably those whose upsetting would be most likely to affect the balance of the contract. The fundamental alteration of the legal circumstances prevailing at the time of the conclusion of the contract can also be taken into account. A change in legislation can affect significantly the performance of current contracts. The phenomenon was already examined when discussing *force majeure* clauses,[12] where it was shown that contractual stipulations often cover, at the same time, situations where the legal modification renders performance impossible and those where performance is simply made more onerous. We shall quote again a particularly sophisticated clause of this kind:

"A "Change in Law" means:

"(a) the adoption, promulgation, modification, repeal or re-interpretation after the effective Date by any Governmental Entity of any Law of (*country*), including, without limitation, a decision of a Governmental Entity after the Effective Date, which (or the effects of which) amends or conflicts with the Laws of (*country*) established or in effect as of the Effective Date, or

"(b) the imposition after the Effective Date by a Governmental Entity of any term or condition in connection with the issuance, renewal, extension, replacement or modification of any Consent,

that in either case contributes to a Change in Costs, requires a Statutory Modification, renders the Financing Documents unlaw-

[12] Cf. *supra*, Chapter 8, pp. 411–412. This passage also makes the comparison with so-called "stabilization clauses."

ful, unenforceable, invalid or void or establishes requirements for, or imposes restrictions on the construction, operation, maintenance, financing, insurance or ownership of the Complex or the Company, or the prices payable under the Agreement, that are more restrictive or more onerous than the most restrictive or most onerous requirements (i) in effect as of the Effective Date, (ii) specified in any applications, or other documents filed in connection with such applications, for any Consent filed by the Company on or before the Commercial Operations Date, so long as such requirements are consistent with the Laws of (*country*) in effect as of the Effective Date or (iii) agreed to by the Company in any agreement in the Security Package."

Approaching the problem of the definition of the hypothesis from another angle, some clauses do not make any more reference, even implicitly, to the circumstances that are capable of being modified. They limit such reference to the case where:

"... *l'exécution de l'une ou de l'autre clause* de la convention provoquerait une rupture appréciable (of the parties' relative position) ..."

or to the case where:

". . . à *l'expérience,* il s'avérerait qu'une clause de la convention provoque une rupture appréciable (of this position) . . ."

Such wording gives the hardship clause an extremely wide scope, probably a scope that is both too broad and too imprecise.

(iii) Specific Circumstances. By way of contrast, many of the examined clauses referred to *events which were much more specific,* often particular to the sector in question, or to one of the parties. Examples:

- ". . . les *modifications des charges* de toutes natures, les *hausses des matières premières* ou autres causes conduisant à une aggravation importante des coûts de fabrication . . ."
- "In the event that during the term of this Agreement the *producer basis for . . . is discontinued or ceases to be the representative basis* in Europe for the purchase or sale of . . ."
- "Si la *production d'acier* provenant de fontes hématites atteint 20% de la production totale de l'aciérie de . . ."
- ". . . *a novel economically available source of products* . . ."
- ". . . *environmental prescriptions* forcing the designated receiving smelter to undertake new endeavours for providing, eliminating and reducing certain elements in its production process or its emissions . . ."

- "... en cas *d'application de nouveaux droits d' importation ou d'exportation* ..."
- "... *discriminatory Governmental action or regulations on differential customs duties* ..."
- "Toutes *difficultés* ... (concerning) *l'obtention de devises, à des mesures de politique commerciale, au contingentement,* à la *manipulation monétaire* ...[13]
- "Les dispositions de la présente Convention ont été arrêtées en fonction des données juridiques, fiscales et monétaires, économiques et financières existant à la date de signature de la présente Convention dans les pays où sont situés les sièges sociaux du Prêteur et de l'Emprunteur ou dans le pays tiers par l'intermédiaire duquel des paiements sont effectués ainsi qu'en fonction des conditions économiques et financières internationales à cette même date."
- "... *changes in monetary values* ..."
- "dans les cas ou ... le Gouvernement (of country Z) prendait des *mesures* faisant obstacle à l'exécution de la présente convention, décrèterait un *moratoire* général ou introduirait une *demande de consolidation* de ses dettes extérieures, ou si un *retard généralisé* venait à être constaté dans les transferts en provenance (from country Z)."
- "... dans le cas où ... la *B.I.R.D. vendrait à suspendre son concours à* ..."
- "... *changement dans la situation de l'acheteur,* tel que décès, incapacité, faillite, suspension de paiement, cessation de commerce, modification aux statuts, etc. ..."
- "If the long term need of ... (product) of the purchaser would drastically be decreased by such a volume that this Agreement would be financially unacceptable for the parties. ..."

It is clear that to be specific is not always the same as to be precise, and to establish the existence of given circumstances (e.g., changes in monetary value) may create real problems.

Here is a clause that brings much more detail to the description of the overturning of circumstances, qualified as "market disruption":

"Market Disruption Event

"11.1 A 'Market Disruption Event' shall occur when:

"11.1.1 the Price Source has not been published or is otherwise not announced on any Price Source Business Day during the relevant Delivery Month; or

[13] In this case, the clause concluded with the word "etc."—already mentioned above under (i).

"11.1.2 the Price Source has ceased to exist or is otherwise unavailable; or

"11.1.3 a change has taken place in the formula for or the method of calculating the closing price of the underlying Commodity Type in respect of which the Price Source is calculated, or a change has taken place in the content, composition or constitution of the underlying Commodity Type; or

"11.1.4 there exists a suspension or material limitation of trading either in futures contracts relating to the Price source traded on a Relevant Exchange, or on a Relevant Exchange in contracts directly relating to the commodity in respect of which the Price Source is calculated.

"11.2 Notwithstanding the foregoing a limitation on net hours and number of days of trading will not constitute a Market Disruption Event if it results from an announced change in the regular business hours of a Relevant Exchange, but a limitation on trading imposed during the course of a day by reason of movements in price otherwise exceeding levels permitted by a Relevant Exchange will constitute a Market Disruption Event.

"11.3 For the avoidance of doubt where the Price Source is a quotation of Platts, Petroleum similar assessment service, there shall be deemed to be no Relevant Exchange."

(iv) Specific Circumstances and "*Imprévision.*" The Group considered the nature of a clause referring to such events sometimes so precise and its relationship, in French and Belgian law, with the theory of *imprévison.*

Imprévison only concerns the occurrence of unforeseeable events: is this always the case with such specific clauses? Clearly one must distinguish between foreseeing the possibility of the occurrence of an event and foreseeing its coming into existence. The discovery at a future date of a new source of supply can be seen by the parties as a possibility, but it does not mean that this discovery was foreseeable initially. Moreover, *imprévision* also concerns the consequences that the occurrence of the event might have on the contract. If, without straining the imagination, the parties are in a position to conclude at the outset that the eventual discovery of a new source of supply might pose a risk to the contract, they are certainly not in a position to make a pre-estimate of such consequences. The distinctive characteristic of the hardship clause thus clearly re-appears when the parties provide for a procedure to re-negotiate the contract, being quite unable to agree on a formula for automatic amendment at the outset.

To provide for the proportional adaptation of the price in the event of the alteration of the relationship between two currencies or in the event of a rise in the cost of raw materials, is to have a currency exchange clause or an index clause. Where the parties agree that under the same circumstances, they shall meet to examine the future of the contract, they stipulate a hardship clause. In such a situation, the parties consider that, in view of the possible extent of the feared fluctuations and the characteristics of the contract, they cannot solely rely on an automatic adaptation mechanism.

It is therefore suggested that a reference to a specific event does not necessarily remove the unforeseeable nature of this event and that above all, the hardship situation is marked by the uncertainty existing at the outset as to the possible consequences to the contract from the occurrence of such an event. This was not the unanimous opinion of the Group, certain members believing that such a specific hardship clause bears little relationship to the theory of *imprévision.* The Group has, in any event, agreed on the need to rid the subject of all dogmatism. Contracts, in practice, deal with an infinite variety of clauses. If it were useful, for reference purposes, to try and establish the categories and characteristics of such clauses, it would be unwise to disregard the whole range of hybrid and intermediary situations.

(v) Combination of Specific and General Circumstances. One frequently finds a combination of the two ways of determining the circumstances: first, the use of general wording, followed by a series of examples of specific circumstances. Examples:

- "En cas de survenace *d'événements économiques* imprévisibles ou exclus par les prévisions qu'ont admises acheteur et vendeur (*telles sont notamment* les modifications de charges de toutes natures . . . , les hausses des matières premières, ou autres causes conduisant à une aggravation importante des coûts de fabrication) . . ."
- "If owing to *changed circumstances such as* changes in monetary values or discriminatory Governmental action or regulations or differential customs duties . . ."
- "Dans le cas de *modifications* importantes pouvant affecter le *système monétaire international,* modifications *notamment* susceptibles d'entraîner des distorsions sérieuses dans les relations entre les monnaies auxquelles il est fait référence dans ce contrat . . ."
- "En cas de survenance *d'événements imprévisibles* . . . Il en sera ainsi *notamment* en cas d'application de nouveaux droits d'exportation ou d'importation et en cas de modification de droit ou de fait dans les parités actuelles du dollar USA, du franc belge et du florin"
- "If in the course of the performance of this contract unfairness or prejudice or obvious hardship to either party is expected or dis-

closed . . . (the description of the relevant procedure follows) . . . It is understood that the foregoing includes *inter alia* the following: 1) Monetary events and/or alterations; 2) Environmental prescriptions . . ."

- ". . . in the event of a new situation, e.g. the possibility of an acquisition in the market sector covered by this Agreement. . . ."

This type of wording seems to have its advantages. It avoids possible discussions as to the inclusion of certain specific circumstances in the area covered by the general formula, while avoiding the inconvenience of a limited series of specific circumstances.[14]

(vi) Excluded Circumstances. A few clauses take care to *exclude* expressly the occurrence of certain specified *circumstances* from the application of the hardship clause. Thus:

- "Price control by the Government of the state of the relevant buyer affecting the price of . . . in the market shall not be considered to constitute substantial hardship."
- ". . . the occurrence of any event beyond the reasonable control of either the Ministry or the Concession Company, other than an event of Force Majeure and other than any 'material adverse governmental action,' as such term is defined in Clause 18.4."

This exclusion may be implicit when it results from the application to certain fixed events of other provisions of the contract. Example:

> ". . . notwithstanding the effect of the other relieving or adjusting provisions of this Agreement."

It is worth recalling that the events covered by the hardship clause formula are only covered when they give rise to certain defined consequences on the economic basis of the contract.

C. Consequences

A hardship situation exists when the events in question result in the upsetting of the balance of the contract. Here again, the clauses examined vary greatly in their wording.

1. Prejudice

The simplest way of describing the consequences is to state that the economic basis of the contract is altered in such a way as to *prejudice one of the parties*. Examples:

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[14] A similar discussion concerns *force majeure* clauses: cf. *supra*, Chapter 8, pp. 413–414.

- "si . . . le prêteur était soumis à toute mesure monétaire ou financière entraînant *un surcroît de charge* relative à sa participation au crédit . . ."
- ". . . si, par suite de circonstances . . . , l'économie des rapports contractuels venait à se trouver modifiée au point de rendre *préjudiciable* pour l'une des parties l'exécution de ses obligations. . . ."

In another clause the wording is reversed, but the sense is the same as above:

> ". . . la présente convention est établie entre deux partenaires qui ne cherchent pas à profiter d'un *avantage* quelconque qui serait dû à des circonstances extraordinaires ou non prévues."

These unqualified clauses give the hardship clause a scope which appears dangerously wide.

2. Objective Criteria

In general, the clauses examined do not simply require some form of damage; they also require that the resulting imbalance be considerable. Examples:

- ". . . une rupture *appréciable* (in the parties' relative position) . . ."
- ". . . des charges *sensiblement* plus lourdes que celles prévues à la signature du présent contrat . . ."
- ". . . *substantial economic hardship* . . ."
- ". . . *substantial and disproportionate* prejudice to either party . . ."
- ". . . pour effet que l'une (of the parties) retire du présent contrat des avantages *hors de proportion* avec ses obligations . . ."
- "un préjudice matériel *exagéré* . . ."
- "*obvious* hardship to either party . . ."
- "lorsque ces événements ont pour effet de *bouleverser* les bases économiques de contrat au préjudice de l'une ou de l'autre des parties . . ."
- ". . . pour effet de bouleverser l'économie du contrat . . ."
- "si les avantages de la présente convention ont été *bouleversés* de façon fondamentale . . ."

Other clauses seem to express a similar idea but in less explicit terms:

- ". . . telles que certaines dispositons de la présente convention deviendraient *inapplicables dans la forme prévue* . . ."
- ". . . *empêchant* l'exécution (de la convention) dans des *conditions normales*. . . ."[15]

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[15] These last clauses borrow the wording of *force majeure* clauses that, *as a rule*, cover

All the above clauses have the advantage of avoiding the re-appraisal of the contract on the simple occurrence of any modification of the advantages which one party hoped to obtain. As far as consequences are concerned, they confirm the exceptional nature of the working of hardship clauses. But the general nature of the criteria chosen (substantial, obvious, etc.) runs the risk of raising serious problems of interpretation when one party invokes the clause.

3. *Subjective Criteria*

Some clauses add or substitute *subjective criteria* for the objective criteria that have just been discussed in order to qualify the consequences of the events in question have on the contract:

- "... telles que l'application de la présente convention aboutirait à des conséquences *inéquitables* pour l'une ou l'autre des parties ..."
- "... imposent à l'une des parties une charge *inéquitable*, découlant du présent protocole ..."
- "*undue* hardship to either party ..."
- "*undue* hardship or *inequity* ..."
- "les parties déclarent que leur intention est que cette convention se déroule dans un esprit *d'équité* et sans qu'un préjudice matériel exagéré puisse en résulter, ni pour le vendeur, ni pour l'acheteur. S'il advenait qu'une telle situation préjudiciable soit à craindre ou vienne à se réaliser ..."[16]
- "... *unfairness* or substantial and disproportionate prejudice to the interests of either ..."

These references to equity and fairness were the subject of lively debate among members of the Group, some of them holding that they confer a dangerous imprecision on the clause, others considering such criteria to be normal in commercial law and practice. As the same concepts re-appear with respect to the procedure for amendment of the contract, a more detailed discussion will be presented later.[17]

4. *Specific Consequences*

A few of the clauses examined refer to more specific consequences:

- "Si les conditions du marché devenaient telles que le *prix* de vente se révélait inférieur à ... (figures)"

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those situations in which the performance of the contract becomes completely impossible. Cf. *supra*, Chapter 8.

[16] It is worth noting the technique of referring to a preamble used in this clause.

[17] Cf. *infra*, pp. 477–480.

- . . . pour effet de renchérir le coût des ressources en devises ou des crédits ou de *réduire le montant* en principal ou en intérêts à percevoir par la banque . . ."
- "which place said party in the situation that . . . all *annual costs* . . . associated with or related to (. . .) which is the subject of this Agreement *exceed the annual proceeds* derived from the sale of said (. . .) . . ."
- "événements . . . de nature à entraîner un *retrait de garantie de l'Office National du Ducroire* . . ."

Those members of the group against the "consequences" being qualified in too general terms showed their preference for these latter clauses. The parties should make every endeavor to decide at the outset, and as precisely as possible, the type of economic disturbance of the contract capable of bringing about its amendment. The clauses, which have just been referred to, are certainly not all entirely satisfactory: some of them contain a certain degree of imprecision. But as examples, they may serve to assist in the drafting of other wordings, which would make the implementation of hardship clauses less problematic. The Group suggests that special attention be paid to the study of criteria, which should be as objective as possible as far as consequences are concerned. This need is most urgent as hardship clauses often already contain a considerable element of uncertainty about the events in question.[18]

D. Establishing the Existence of the Relevant Situation

We will look at the procedure to be applied when the hardship situation occurs. This procedure often provides for re-negotiation of the contract. First of all, establishing that the situation in question exists, can in itself present considerable problems, particularly in light of the imprecise nature of the criteria used.

It is certainly possible to let one party decide unilaterally:

"Un événement ou un changement qui, *selon l'appréciation du prêteur*, a ou pourrait / est susceptible d'avoir un effet défavorable important sur. . . ."

Such appraisal must certainly be exercised in good faith, but the risk of abuse cannot be underestimated. It is preferable to set up an independent procedure for establishing the existence of hardship. Examples:

- "A défaut d'accord des parties sur le principe de la révision, la question est, à l'initiative de la partie la plus diligente, soumise à

[18] Cf. *supra*, pp. 463–470.

l'arbitrage . . . Les arbitres décident s'il y a lieu à révision de la ou des clauses incriminées."

- ". . . the (prejudiced) party . . . may by notice request the other for a meeting to determine if said occurrence has happened . . . If the seller and the buyer have not agreed . . . within sixty days . . . either party may require the matter to be submitted for arbitration . . . The arbitrators shall determine whether the aforesaid occurence has happened . . ."
- "A défaut d'acord, il est convenu que chacune des parties désignera un expert économiste assisté éventuellement d'un expert financier que se réuniront pour examiner si les avantages de la présente convention ont été bouleversés de façon fondamentale suite à un événement imprévisible."

The nature of the role played in such circumstances by the "arbitrator" or the "expert" used to pose severe problems. We will return to these when considering the procedure for the amendment of the contract.

The three clauses quoted suggest, however, the existence of another fundamental question, the solution of which largely determines the efficiency of hardship clauses. At such time as one of the parties intends to invoke the clause, there is the risk that the other contracting party benefiting from advantages, which correspond to the damage suffered by its partner, will seek to escape from the re-negotiation of the contract. The temptation to contest the existence of the relevant situation can be great and is indeed encouraged by the frequently imprecise nature of the relevant criteria. Yet, this problem rarely seems to be appreciated by those who draft these clauses. At least, none of the clauses examined, other than the three examples just quoted, made reference to this problem.

In the absence of any special procedure being expressly provided for, the unjustified refusal of one of the parties to admit the existence of the relevant situation (refusal even to examine the circumstances in question and their consequences, bad faith in carrying out this examination) may lead to involving the contractual responsibility of the party in question. In French law, for example, the wronged contracting party could try to invoke *exceptio non adimpleti contractus* in order to provisionally withhold performance of its own obligations.[19] It would also have recourse to the courts to obtain either specific performance (which could entail the court considering the existence of the relevant situation) or the termination of the contract and the award of damages where applicable.[20] However, if the contract

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[19] But are the obligations in question sufficiently related? On this requirement in French law, cf. J. Ghestin, L'exception d'inexécution, in *Les sanctions de l'inexécution des obligations contractuelles*, M. Fontaine & G. Viney (eds.), Brussels and Paris, 2001, pp. 8–13.

[20] But how are the damages to be calculated? Is it conceivable that the judge might

contains a general arbitration clause, this would seem to be applicable in this particular case; the refusal to admit the existence of the relevant situation would be assessed by the arbitrators.

The numerous uncertainties associated with relying on the existing legal procedure and in view of the refusal to apply such a delicate clause, should encourage the parties to be more aware of the problem and provide for specific solutions to it in the drafting of hardship clauses. One could, for example, rely entirely on the fairness of the other contracting party by providing that in the absence of amicable agreement on the existence of the hardship situation, no further recourse would be possible and the contract would subsist on the initial terms. But this solution can prove economically unbearable. Another possibility would be to permit, in the absence of agreement on the relevant situation, the unilateral termination of the contract subject to prior notification. A third solution, perhaps the best, is offered by the three clauses quoted above which provide for a special procedure in this situation, namely recourse to arbitration or an expert's opinion.

E. Grace Period

One special provision examined provides for a grace period between the conclusion of the contract and the first moment when the hardship clause can be invoked and also a restriction as to the frequency of recourse to such a clause:

> "This section may not be invoked by seller or buyer prior to the first day of October 20 . . . , and no more often than once every two years."

It is once again a question of reducing the element of uncertainty which a hardship clause introduces into a contract.

F. Procedure

When hardship is verified, the clause provides for a procedure to be followed. In the first place, the party experiencing hardship circumstances must give notice to the other party. The contract will then, in principle, be amended, usually under the guidance of certain criteria. If the parties come to disagree at this stage, the clause sometimes provides that the contract will be terminated, or that its re-adaptation will be entrusted to arbitrators.

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refer to the hypothetical results of the renegotiation which has not yet taken place? Comp. *supra* Chapter 1, pp. 50–53, concerning letters of intent.

1. *Notice*

Here are three examples of clauses providing for notification of the occurrence of hardship circumstances:

- "That Party may notify the other in writing that it wishes to meet and review the conditions of the Agreement in the light of the changed business conditions."
- "If HARDSHIP occurs, A shall notify B thereof within thirty (30) days of becoming aware thereof together with a description of the event and its consequences for A."
- "In case of an inequitable economic hardship, the party proposing a change or negotiations shall give notice thereof to the other party, setting forth a proposal for resolving the inequity."

A well-drafted clause should set a time limit, as well as the form (e.g., in writing) and contents (a description of the circumstances and their effects, possibly already a proposal for readjusting the contract) of the required notice.

2. *Re-Adaptation of the Contract*

The first step if for the parties is to try and re-adapt the contract between themselves. For example:

- ". . . cette ou ces clauses seront *revues* . . ."
- ". . . *revoir* les modalités d'application . . ."
- ". . . les parties procéderaient à une *révision* du contrat . . ."
- ". . . either party shall have the right to ask for *renegociations*."
- ". . . à se mettre d'accord sur une *adaptation* du prix . . ."
- ". . . the (prejudiced) party . . . may by notice request the other for a meeting . . . to agree upon what, if any, *adjustment* in the price then in force under this Agreement and/or other terms and conditions thereof is justified . . ."
- ". . . les parties se consulteront aux fins de trouver en commun des *ajustements* équitables à cet accord."
- ". . . that the party shall have the right to require the other party to participate in a joint examination of the position with a view to determining whether *revision* or *modification* of the provisions thereof is required, and if so, what revision or modification would be appropriate and equitable in the circumstances."

Some wordings do not limit the aim of a discussion to the mere reviewing of the contract.

- ". . . the parties will use their best endeavours to *agree such an action as may be necessary* . . ."

- "... les deux contractants ... se concerteraient ... pour *déterminer* en commun le *moyen de remédier* promptement et adéquatement à cette situation préjudicable et, les cas échéant, pour apporter au contrat les amendements nécessaires."
- "... les parties conviennent de rechercher en commun les *moyens aptes à remédier* (the damaging situation) ..."

The following clause, on the contrary, appears to be more restrictive. It narrows at the outset the possible types of amendments:

> "The Ministry and the Concession Company shall consult within ten (10) days after notice with a view to reaching a mutually satisfactory resolution of the situation, which could, if the Parties do agree, result in either the modification of then existing toll rates and/or an extension of any applicable deadline for the Concession Company to meet its obligations under the Concession Contract and/or reduction in amounts which would otherwise be payable to the Ministry under the Concession Contract. These shall be the only type of remedies available for events arising under this Clause."

Finally we shall recall a clause already quoted above, where the notice of hardship circumstances must already contain a proposal for readaptation of the contract:

> "In case of an inequitable economic hardship, the party proposing a change or negotiations shall give notice thereof to the other party, setting forth a proposal for resolving the inequity."

3. *Objective, Subjective and Mixed Criteria*

In order to impose certain boundaries to the amendment of the contract, most of the clauses received propose certain criteria to guide the renegotiation. Here again, as with the qualification of a fundamental change in the contract, there are two orientations: some clauses apply objective criteria, which aim in general to re-establish the original balance between the respective obligations of the parties, but most wordings use general limits with subjective criteria, referring to fairness and equity. Both types of criteria are sometimes combined.

Objective criteria:

> "... de façon à replacer les parties dans une *position d'équilibre comparable à celle qui existait au moment de la conclusion* du présent contrat."

Subjective criteria:

- ". . . *équitablement* dans *l'esprit d'objectivité et de loyauté* qui est à la base des relations existant entre les parties . . ."
- ". . . afin que tout se passe en *parfaite loyauté réciproque* . . ."
- ". . . *dans le même esprit* que celui qui a présidé à la conclusion des présentes . . ."
- ". . . in *fairness* to the parties . . ."
- ". . . to come to a *mutually satisfactory* agreement . . ."
- ". . . des ajustements *équitables* . . ."
- ". . . *appropriate and equitable* in the circumstances . . ."
- ". . . such action as may be appropriate to abate such *unfairness or undue hardship* . . ."
- ". . . a *reasonable* agreement . . . acceptable to both parties. . ."

The following wording could probably be construed as a subjective criterium:

- ". . . pour but *d'éviter* que l'une des parties ne tire *profit* au *détriment* de l'autre partie de la nouvelle situation ainsi créée . . ."

Combined criteria:

- ". . . afin de préverser l'esprit de *bonne foi* qui prévalait au moment de la signature du contrat et qu' ainsi celui-ci puisse s'éxécuter ou continuer à s'exécuter *sans préjudice disproportionné* pour l'une ou l'autre des parties . . ."
- ". . . with *fairness* and *without substantial and disproportionate prejudice* to the interest of the either . . ."
- ". . . dans le même esprit de *bonne foi* que celui qui a présidé à la conclusion de la présente convention. . . de façon à replacer les parties dans une *position d' équilibre comparable à celle qui existait au moment de la conclusion* de la présente convention. . . ."

It is clearly useful to indicate from the start the criteria that will guide the re-negotiation, which can take many directions, the final result being the adequate adjustment of the parties' respective obligations. It seems that the general preference of the members of the Group would go to the objective criterion of re-establishing a balance fairly close to the original one. On the other hand, two conflicting opinions were expressed as regards the use of subjective criteria, and, in particular, that of equity. Without pretending to be conclusive, we will report here the principal considerations put forward during the lively debate which followed.

Against the equity criterion:

1. It is imprecise, uncertain, and removes all security from legal relations.
2. It is superfluous, if it only means that each must receive its due.
3. It is dangerous because, in an international contract, each party's idea of equity can be infinitely variable.
4. It has a moral coloration, which allows any kind of judgment (e.g., is it moral to comply with or to disregard a clause excluding liability?).
5. If the application of this criterion is entrusted to an arbitrator, there is a risk that he will interpret this as authorizing him to look for a solution outside the contract, outside the law. In order to avoid "government by judges," all the elements required for the arbitrator to form his opinion must be provided in the contract itself.

Those in favor of this position recommend that reference be made as far as possible to the objective criterion of the original balance of the contractual obligations, or if possible, to even more precise criteria (levels or ratios of prices, of costs, etc.).

For the equity criterion:

1. This criterion is a usual standard of contract law of certain countries (see Article 1135 of the French and Belgian Civil Code).
2. Its moral coloration must not be rejected. Businessmen are not insensitive to such notions (equity, good faith, fairness).
3. The content of the notion of equity is not entirely imprecise when parties have the same homogenous background.
4. When the circumstances in which the contract was concluded have been radically changed, the contract does not provide any longer the criteria required; external criteria must then be resorted to, in order to indicate the spirit in which the revision must be made.
5. Even objective criteria often include subjective judgments (e.g., "*excessive* unbalance between the respective obligations"; "*fundamental* upsetting of the initial contractual equilibrium").
6. From a strategic point of view, it is perhaps not advisable during the negotiations prior to the conclusion of the contract itself, to try and foresee with too much precision the adaptations that might become necessary in the future.
7. Some objective criteria might be indiscreet, for example, if a price structure must be revealed.

To the above elements drawn from the Group's discussions, one can add that standards, which may appear to be *subjective* in certain jurisdictions

may, on the contrary, be considered *objective* under other legal systems. For instance, in German, Swiss or Dutch law, notions such as "good faith," *Treu und Glauben* or "fairness" refer to objective norms of behavior, to the attitude that can be expected from a reasonable party under the same circumstances.

4. Disagreement Over the Content of the Revision

The majority of hardship clauses examined fail to provide any guiding principle in case the parties fail to agree on the revision of the contract. Certain solutions can be found in the general law, but their application seems difficult.

Several clauses, however, have foreseen the possibility of such a disagreement and have provided, in this case, either the possibility of terminating the contract (or of suspending its application), or resorting to arbitration.

a. Lack of Specific Provision

If no provisions have been made in the contract, what rules would be applicable in case of disagreement between the parties over the revision of the contract? The problem is similar to the one encountered above concerning the disagreement as to the existence of the relevant situation.[21]

In the first place, there is certainly a contractual obligation to re-negotiate, and the party, who would try to avoid it although the hardship circumstances have evidently materialized, would incur its contractual liability under the applicable law.

The problem is much more delicate when the negotiation is already underway, but the parties cannot reach an agreement. In itself, the obligation to re-negotiate does not entail the obligation to reach an agreement.

This is clearly stated in the following clause:

> "The Parties shall make good faith efforts to resolve the economic difficulties on mutually acceptable terms however there shall be no obligation hereunder for the Parties to reach agreement hereon."

Such a clause does not solve everything, as the conduct of each negotiator remains to be gauged. The absence of an obligation to reach an agreement does not equal the absence of any duty to behave appropriately during the re-negotiation,[22] in reference to the criteria provided by the

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[21] Cf. *supra*, pp. 473–475.

[22] Comp. *supra*, Chapter 1, concerning letters of intent and the parties' obligations in the course of the initial negotiation of the contract.

clause itself (in connection with these, the difficulties to which subjective criteria give rise have been examined). Under French law, for example, the obligation to participate in negotiations towards a new agreement must be, it seems, only an *obligation de moyens*; a party's liability will be incurred only owing to a proven fault in the re-negotiation. If one of the negotiators' liability is incurred, the other party will have at its disposal the usual remedies granted by the general law (legal action to terminate the contract, damages), but it is readily obvious that these will be inadequate in numerous situations where hardship clauses may apply (long-term supply agreements, contracts that, because of their contents, "condemn" the contracting parties to reach an understanding, etc.). If, on the contrary, it turns out that the failure of the negotiations cannot be attributed to the fault of either party (both parties remaining in perfect good faith in their respective positions), there is no other solution than keeping the contract as it is, but is this economically feasible?

In view of all these uncertainties, it is recommended to provide in the hardship clause a procedure that will apply in case the parties cannot reach an amicable agreement concerning the revision of the contract.

b. Termination of the Contract

In practice one of the solutions consists in the possible termination of the contract. For example:

- "Si (les parties) ne parviennent pas à un accord dans un délai raisonnable, chacune d'elles pourra invoquer la *résiliation* du contrat ou de la partie non livrée de la commande, le tout sans indemnité."[23]
- "A défaut d'accord des parties dans un délai de. . . jours à compter de la demande d'adaptation, chacune des parties aura la faculté de *mettre fin* au contrat, sans indemnité, moyennant un préavis de . . . jours, à notifier par lettre recommandée. Pendant ce préavis, les fournitures se poursuivront sans modification des conditions contractuelles."[24]

In the second clause, several useful specifications are present, which are lacking in the first one: a definite period of time is allowed for the conclusion of the negotiation, a requirement of advance notice, the form and duration of such notice and to the fate of the contract during the period of notice; this last point can be phrased in a broader fashion:

[23] What would be the consequence of such a clause for coverage of the risks prior to delivery in connection with export credit insurance?

[24] The power to terminate the contract is reserved here to the party who asked for the application of a hardship clause, but the hardship clause itself is not unilateral; each party has the right to avail itself of it. Some examples of unilateral clauses will be examined *infra*, p. 486.

"If any such notice of termination is given, all terms and conditions of this Contract shall remain the same as these in effect prior to the original notice of hardship until such termination becomes effective."

The following examples reserve the right of terminating the contract to only one of the parties:

- "If the parties fail to reach agreement within 60 days of the delivery of such notice, the party suffering the inequitable hardship may terminate the Contract, effective twelve (12) months after the date of the original notice of hardship by giving a notice of termination within five days of the end of said 60-day period . . ."
- "A défaut d'accord des parties sur telle adaptation dans un délai de trente jours de la demande d'adaptation, la partie qui aura invoqué la clause aura le droit de mettre fin au contrat sans préavis ni indemnité. Elle devra user de cette faculté dans un délai supplémentaire de trente jours, faute de quoi le contrat s'exécutera sans modification aucune des conditions contractuelles."

An interesting aspect of this last clause is the provision whereby the contractual relations will continue without change if termination is not requested, even though the renegotiation fails.

c. Suspension of the Contract

One of the clauses received provides for a different system. If there is disagreement about the new arrangement, the contract is suspended during a certain period at the end of which, if the hardship circumstances are still present, each party has the power to terminate the contract:

"If . . . the parties shall fail to agree within a reasonable time not to exceed . . . days, this Agreement shall be *suspended* for a maximum of . . . months on the written request of either party. Should the cause of such unfairness or undue hardship remain unchanged after this period of suspension, then either party shall be entitled to cancel this Agreement forthwith on written notice without liability for damages."

This system is interesting because, here, the parties think it is conceivable from an economic point of view that the performance of their respective engagements should be interrupted for several months, pending resumption or final termination.

d. Intervention of Third Parties

Some of the clauses provided that, in case of disagreement between the parties concerning the re-adaptation of the contract, the problem will be submitted to the judgment of third parties, arbitrators or experts. It should be borne in mind that some clauses already provided the possibility of such an intervention in case of disagreement relating to the materialization of hardship circumstances.

(a) Conditions. In the first place, the conditions under which this procedure is activated must be defined:

- "A défaut d'accord des parties sur les modifictions à apporter . . ."
- "Au cas où les parties ne parviendraient pas à trouver elles-mêmes une solution à leurs difficultés . . ."
- "Si les parties ne parvenaient pas à s'entendre . . ."
- "Failing which such agreement . . ."

As was the case above regarding the power to terminate, some clauses allow a certain time for negotiations to be conducted before arbitration takes place:

- "If the parties have not agreed a mutually acceptable solution within sixty days after the notice requesting a meeting . . ."
- "Si aucun n'était intervenu dans un délai de soixante jours à compter de la demande de révision . . ."

(b) Qualifications of Intervening Third Parties. It is then provided that the decision about the contract will be submitted to one or several third parties referred to by various names:

- ". . . la question est . . . soumise à *l'arbitrage* . . ."
- ". . . (the modifications) . . . seraient arrêtées par *l'arbitre* ou les *arbitres* . . ."
- ". . . elles feraient appel à *l'arbitrage* . . ."
- ". . . either party may request the matter to be submitted for *arbitration* . . ."
- ". . . the matter may be referred by either party for determination by *experts* . . ."
- ". . . (les parties) s'en remettraient à la décision d'un *conciliateur* . . ."
- ". . . the matter shall be referred for decision to three *referees* . . . All such referees shall be deemed to be acting as *experts* and not as arbitrators."

As the last clause quoted suggests, what could be involved here is far more than just a question of names. We shall deal with this later on and we

shall examine, for the moment, the various aspects of intervention by a third party (or parties).[25]

(c) Designation of Third Parties. The third party (or parties) are designated, in general, according to the procedure described in the general arbitration clause of the contract, to which reference is made:

> ". . . l'arbitre ou les arbitres dont la désignation est prévue à l'article 10 . . ."

But a particular mode of designation can also be provided:

- ". . . un conciliateur unique à désigner de commun accord . . ."
- ". . . experts to be appointed in the manner set out in Article XVIII hereof save that the appointment of the third experts referred to in Clause 1 (c) of that Article shall in any event be made by . . ."
- ". . . three referees who shall be persons fitted by the possession of expert knowledge for such decision. Each of the parties here to shall be entitled to appoint one referee and the third one shall be nominated by mutual agreement between the parties or failing such agreement by the President for the time being of the International Chamber of Commerce."

(d) Mission. What is the mission of this third party (or third parties)? This is a crucial point. This mission is sometimes implicitly determined by referring to the object of the renegotiation attempted by the parties themselves:

- ". . . les deux contractants, à l'initiative de la partie préjudiciée, se concerteraient, dans un esprit de compréhension et d'équité, pour déterminer en commun le moyen de remédier promptement et adéquatement à cette situation préjudiciable et, le cas échéant, pour apporter au contrat les amendements nécessaires. Au cas où les parties ne parviendraient pas à trouver elles-mêmes une solution à leurs difficultés, elles feraient appel à l'arbitrage prévu au contrat."

Sometimes, the clauses define in a more precise way the mission of the third party:

- "Les arbitres, après avoir entendu les parties, peuvent, soit modifier d'autorité les clauses litigieuses dans la mesure nécessaire pour rétablir la position relative des parties, soit résoudre la convention."
- "The arbitrators shall determine . . . what adjustment, if any, in the said price or in the other terms and conditions should be made for the purposes of paragraph (a) . . ."

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[25] Cf. *infra*, pp. 490–491.

(e) Criteria. We have seen that most of the clauses provide *objective* or *subjective criteria* in order to guide the re-negotiation by the parties. Sometimes, criteria are also provided to third parties: either the criteria applicable to the parties themselves are rendered implicitly applicable to the third party, or specific criteria are defined in connection with the intervention of the arbitrators, where the same two orientations as before are also found:

- ". . . dans la mesure nécessaire pour rétablir la position relative des parties . . ."
- ". . . de telle sorte que soit respecté l'esprit de collaboration et de répartition équitable des résultats qui a présidé à l'établissement de la présente association"
- ". . . having due regard for the interests of the other party . . ."

It must be borne in mind that the bias of certain members of the group against notions like good faith or equity was particularly strong when these criteria were meant to guide the intervention of third parties in the contractual relations.

(f) Procedure. The procedure to be followed in connection with the intervention of the arbitrators is sometimes determined indirectly when the hardship clause refers to the original arbitration clause in the contract. In other cases, few indications were found in the clauses discussed by the group. For example:

- "La question est, *à l'initiative de la partie la plus diligente*, soumise à l'arbitre . . ."
- ". . . les arbitres, *après avoir entendu les parties* . . ."

(g) Binding Force of the Decision. To what extent is the decision reached by the third party (or parties) binding? This aspect is linked to the problem of the nature of the role of such arbitrators. The solutions embodied in some of the hardship clauses that have been examined are as follows:

- ". . . (the arbitrators) fixent librement la date d'entrée en vigueur de leur *décision* . . ."
- ". . . des arbitres . . . qui *statueraient* . . ."
- ". . . (parties) s'en remettraient à la *décision* d'un conciliateur . . ."
- ". . . their *decision* shall be *final* and *conclusive* . . ."
- ". . . any revised prices or other conditions so *determined by said arbitrators* shall take effect on the date when notice of arbitration was first given unless the arbitrators decide a later date."

A very elaborate clause was submitted to the Group, in which a procedure that moderates the binding force of the decision of the arbitrators was

defined, which offers the parties a number of possibilities. After the arbitrators have reached their decision, the party who did not request arbitration, can, if it finds this decision unsatisfactory, terminate the contract after proper notice during which the contract is maintained in its original form and conditions. On reception of this notice, the other party can either accept the termination of the contract or decide that the contract will continue in its original form and conditions as if there had been no arbitration or else postpone the termination of the contract to a further date, and this choice is binding on the first party.

e. Fate of the Contract During Re-Negotiation

There was no special provision in the clauses brought to the knowledge of the Group about what happens to the contract during the renegotiation.[26] If the contractual relations are deeply upset, and if the performance of the contractual obligations is continuous or by instalments, this problem can be very serious. This grave inconvenience can be mitigated by allowing a certain time period for the conclusion of the renegotiation, either by the parties themselves or through the intervention of arbitrators. In certain cases, however, the temporary suspension of the execution of the contract could be arranged (the suspension here envisaged is suspension during the negotiations, different from the case examined above in which suspension occurs if the negotiations fail).

G. Unilateral Clauses

Some of the hardship clauses examined are unilateral. This does mean only that one of the parties has the possibility to renounce the contract if the re-negotiations fail, but that the application of the whole hardship clause will depend on the will of one of the parties alone: assessing the occurrence of the hypothesis, choosing the rules that will apply. For example:

- "Toutes difficultés survenant après l'acceptation de votre commande relativement à l'obtention de devises, à des mesures de politique commerciale, au contingentement, à la manipulation monétaire, etc. . . . , nous confèrent le droit, suivant les circonstances, de modifier les conditions de paiement, de prolonger les délais de livraison ou de révoquer le contrat. Ce droit n'est pas réciproque."
- "La banque pourra mettre fin à toutes les utilisations du crédit dans le cas de survenance d'événements, notamment d'événements politiques extérieurs ou intérieurs, susceptibles de perturber le fonctionnement normal de l'entreprise du débiteur ou des institutions politiques ou financières de son pays."

[26] Cf., however, some brief indications contained in the clauses quoted *supra*, pp.

H. Return to Normal Circumstances

There can also be a provision for the case when circumstances return to normal. Here is an example:

> "To the extent that any occurrence of hardship as determined under this Section 13.9 shall have decreased or ended then any revision of prices or other conditions pursuant to an arbitration award shall likewise be changed or ended and the terms and conditions of the Agreement (if not already determined pursuant to paragraph b) here of) shall be restored to take account of the said decrease or ending of the occurrence of hardship."

On the other hand, the clause, already examined, whereby the contract is suspended for a certain period if the negotiations fail, grants the power of termination to the parties at the end of this period if the hardship circumstances are still present. This implies that previous relations will be resumed if opposite circumstances prevail.

III. FINAL OBSERVATIONS

This systematic analysis of a large sample of hardship clauses leads to a few general remarks.

(a) Long-Term Contracts in a Changing Environment. A better awareness of the specific traits of long-term contracts is developing.[27] When contractual obligations are to be performed over a more or less lengthy period of time, the implementation of certain traditional principles of contract law calls for some adaptations.

This is the case with the strict application of the principle of sanctity of contracts (*pacta sunt servanda*). The parties are certainly bound by the obligations they have undertaken, but consideration must be given to the fact that such obligations have been accepted in a certain environment, under a certain state of things.

If nothing changes (*rebus sic stantibus*), the parties remain bound by their original contractual provisions. But if the circumstances are deeply modified, generating significant unbalance between the respective obligations, or rendering certain performances economically useless, it is conceivable that some undertakings may have to be reviewed. Such developments are more likely to occur when the contract is to be performed over a long period of time.

481–482, concerning the fate of the contract after notice of termination has been given or in case the right to terminate the contract is not exercised.

[27] Cf. *supra*, p. 212 and note 46, as well as *infra*, pp. 597–598 and 625–628.

However, the essential role played by the principle of sanctity of contracts, as a foundation of an efficient law of contracts, implies that undertakings can only be re-examined when the change in circumstances is substantial, and when it considerably alters the parties' respective situations.

(b) Wide-Spread Acknowledgement of Changed Circumstances by the Different Legal Systems. The very brief comparative law presentation at the beginning of this chapter[28] recalled that most jurisdictions accept to reconsider the contract when circumstances are deeply modified through notions such as *Wegfall der Geschäftsgrundlage, eccesiva onerosità, frustration* or *impracticabiliy.* In this regard, the restrictive position of French and Belgian law is exceptional.

This broad consensus is confirmed by the Unidroit Principles, where Articles 6.2.1 to 6.2.3 deal with the notion of hardship. Hardship is defined as the occurrence of events which *fundamentally alter the equilibrium of the contract,* provided that the events occur or become known to the disadvantaged party after the conclusion of the contract, that they could not reasonably have been taken into account by the disadvantaged party after the conclusion of the contract, that the events are beyond its control and that it did not assume the risk of such events. In case of hardship, the disadvantaged party may require renegotiations. If the parties fail to reach an agreement within a reasonable time, either party may resort to the courts. If the court finds hardship, it may terminate the contract or adapt it with a view to restoring its equilibrium.[29]

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[28] Cf. *supra,* pp. 453–455 and the references given.

[29] On these texts, cf. D. Maskow, Hardship and Force Majeure, 40 *Amer. J. of Comp. Law,* 1992, pp. 657–669; M. Fontaine, Les dispositions relatives au hardship et à la force majeure, in *Contratti commerciali internazionali e Principe Unidroit,* Milan, 1997, pp. 183–191; M. Prado, La théorie du hardship dans les Principes d'Unidroit relatifs aux contrats du commerce international, *Dir. del Comm. Int.,* 1997, pp. 323–373; A.G. Dudko, Hardship in Contract: the Approach of the Unidroit Principles and Legal Developments in Russia, *Unif. Law Rev.,* 2000, pp. 483–509.

Nevertheless, it has been shown that international arbitral tribunals are prudent. Arbitrators have a preference for enforcing contractual provisions (*pacta sunt servanda*), as they often consider that in international trade, professional operators are able, when they wish, to provide for change of circumstances by appropriate clauses. On the trends of arbitral awards in this matter, cf. W. Melis, Force Majeure and Hardship Clauses in International Commercial Contracts in View of the Practice of the ICC Court of Arbitration, *Journ. of Int. Arb.,* 1984, pp. 213–221 (in spite of the title of this article, none of the decisions discussed concerned a contract including a hardship clause); D. Philippe, Pacta sunt servanda et Rebus sic stantibus, in *L'apport de la jurisprudence arbitrale,* Paris, ICC, 1986, pp. 181–259; Ph. Fouchard, E. Gaillard & B. Goldman, *Traité de l'arbitrage commercial international,* Paris, 1996, pp. 28–29; H. Van Houtte, Changed Circumstances and Pacta sunt servanda, in *Transnational Rules in International Commercial Arbitration,* E. Gaillard (ed.), Paris, ICC, 1993, pp. 105–123.

The Principes of European Contract Law also contain provisions on *change of circumstances*, obliging the parties to re-negotiate a contract that has become excessively onerous for one of them, and giving the court several remedial possibilities when the parties fail to reach agreement (Article 6.111).

(c) Inadequacy of the Solutions Given by the Different Legal Systems—Advantages of Hardship Clauses.

The interest of a hardship clause is obvious when the applicable law has a negative approach, as is the case in French and Belgian law. But such clauses are just as frequently stipulated in contracts governed by legal systems that accept to take changes of circumstances into consideration.[30]

The reason is that the remedies made available are generally deemed to be inadequate. This will certainly be the case if the applicable law empowers the judge to terminate the contract. The parties usually want to continue their relationship. But it will also often be the case when the applicable law allows the judge to amend the contract. If the parties prefer adaptation to termination, they hardly consider that a judge—or even an arbitrator—would be the person best qualified to decide of such adaptation.

This explains the relative success of hardship clauses. The parties prefer to organize a procedure in which a change of circumstances triggers re-negotiation with each other in the first place.

The problem will however reappear in case renegotiation fails.

(d) The Inevitable Insecurity of Hardship Clauses. However, drafting a hardship clause is a very delicate matter.

In the first place, it is impossible to solve in a perfect manner the conflict between the inevitable imprecision of the events, which these clauses would regulate, and the desire to clarify, as far as possible, these uncertainties. We have often noted the efforts made by the drafters of these clauses in order to diminish the grounds of insecurity, and we have, in general, approved of them. Attempts have been made to specify the events concerned, to gauge quantitatively the repercussions on the contract, to choose objective criteria to guide the re-negotiation, to organize an adequate procedure, especially under the hypothesis that amicable revision fails, to establish advance notice, etc. But these efforts can never be completely successful owing to the particular nature of the circumstances concerned. The parties

[30] Cf. H. Ullmann, Droit et pratique des clauses de hardship dans le système juridique américain, *I.B.L.J.*, 1988, pp. 889–904.

who agree on a hardship clause must remember that this is inevitable, even though they devote their utmost care to the drafting of the clause.

The other significant difficulty is to arrange the situation when re-negotiation has failed. Many hardship clauses fail to provide for it,[31] thus exposing the parties to serious problems. But none of the possible solutions is excellent. Suspending the contract interrupts the exchange of values, termination is what one wanted to avoid and the intervention of a third party causes problems under certain jurisdictions.[32] However, any of these solutions is better than no provision at all in case renegotiations fail.

(e) Nature of the Intervention of a Third Party in Adapting the Contract. During the first discussions the Working Group devoted to hardship clauses in the 1970s, the nature of the intervention of the third party had appeared to be one of the fundamental problems hardship clauses caused. Although only a minority of received clauses (25 percent) were providing such an intervention, the legal questions involved seemed to be especially important.[33]

Arbitrators, experts, or conciliators? Does not the fact that the drafters of these clauses hesitate as to their wording reveal their embarrassment when faced with such an intervention for its scope seems to be notably different from that of a traditional commercial arbitration?

It was thought, then, that one has to distinguish between the genuine role of an arbitrator, i.e., to settle a legal dispute, and that of a third party invited to modify the contract in view of changed circumstances. The latter case would no longer be arbitration in the proper meaning, but "irrevocable expertise," "economic arbitration" or "contract regulation."

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[31] Cf. *supra*, pp. 480–481.

[32] In this respect, Article 6.2.3 of the Unidroit Principles has met some criticism, when it provides that should renegotiation fail, the court could terminate or readapt the contract (cf. M. Fontaine, Les dispositions relatives au hardship et à la force majeure, in *Contratti commerciali internazionali e Principe Unidroit*, Milan, 1997, pp. 187–188; F. Bortolotti, The Unidroit Principles and the arbitral tribunals, *Unif. Law Rev.*, 2000, pp. 144–145). It is also known that in 1978, the International Chamber of Commerce published rules concerning the adaptation of contracts (ICC Publication. No. 326), which set up a procedure available to parties wishing a third party to intervene, either to fill an initial gap in the contract, or to readapt it within the context of a hardship clause, due to a lack of agreement between the parties themselves. The ICC rules offered two model clauses, one inviting the third party to make a "recommendation," the other one asking the third party to make a "decision" in the name of the parties. These rules were never applied and the ICC eventually abrogated them in 1974 (cf. Ph. Fouchard, E. Gaillard & B. Goldman, *op. cit.*, p. 31).

[33] Cf. the first French edition of this book, *Droit des contrats internationaux*, 1989, pp. 276–277.

The distinction would be far from academic. Arbitration in the classical sense conforms to a precise procedure; compliance with the arbitration award can be enforced through judicial *exequatur*. These rules do not apply to an irrevocable expertise. It is not certain which procedure is applicable if the parties have specified nothing (are there any due process rules to be respected, must the decision mention its grounds, etc.?); the expert's conclusions are integrated in the contract and any dispute arising in this connection can be brought before the courts.

The discussion relates to the more general issue of the intervention of third parties to fill the gaps in a contract, which does not only concern hardship clauses. This issue also appears in other chapters of this book.[34]

There has been an evolution in ideas since this first debate took place. A broader concept of arbitration has developed. "*Malgré sa force théorique, une qualification aussi étroite de la fonction de l'arbitre ne convient ni aux parties ni aux besoins actuels de certaines relations contractuelles internationales.*"[35] The need to resort to arbitration after re-negotiation failed is indeed a situation where the parties disagree. In practice, arbitrators do not hesitate to take up such a role.[36] It is significant that the distinct rules on contract regulation that the International Chamber of Commerce deemed adequate and issued in 1978 were never applied and were abrogated in 1994.[37]

(f) A Model Hardship Clause? The foregoing analysis of a hardship clause should be followed by a synthesis. Could this not take the shape of a model hardship clause? The group did not consider proposing such a clause.

The analysis of about 70 clauses has shown many different aspects of the hardship clause, each of which may be of real importance. In addition, our objections have pointed to various insufficiencies, which drafters of

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[34] Cf. *supra*, Chapter 1, concerning letters of intent, and *infra*, Chapter 10, concerning English clauses.

[35] Cf. Ph. Fouchard, E. Gaillard & B. Goldman, *op. cit.*, p. 28. Cf. also A. Prujiner, L'adaptation forcée du contrat par arbitrage, 37 *Rev. Dr. McGill*, 1992, pp. 428–447, and the references cited; Ch. Jarrosson, Les frontières de l'arbitrage, *Rev. Arb.*, 2001, pp. 5–41.

[36] Cf. the awards referred to by Ph. Fouchard, E. Gaillard & B. Goldman, *op. cit.*, p. 31, as well as P.Y. Gautier, L'arbitrage *Quintette* devant les juges de la Colombie britannique: la clause de *hardship*, invitation à *l'ultra petita*, *Rev. Arb.*, 1991, pp. 611–623. Compare the famous decision rendered on September 28, 1976 by the Cour d'Appel de Paris (*EDF c/ Shell*), discussed in the first French edition of this book (*Droit des contrats internationaux*, 1989, pp. 283–284), where the court did not hesitate to order the parties to meet before an "observer" to try to agree on a price revision, while the court reserved the possibility for itself to decide such a revision in case the parties failed to agree.

[37] Cf. *supra*, note 32.

hardship clauses should remedy. But an "ideal" clause, which would include cumulatively all the improvements suggested, would be a legal monstrosity on account of its size and complexity. In particular, its construction would be so difficult that it could, on its own, cause the failure of the initial negotiation by the parties. It is probably ill-advised, when the contract is being concluded, to emphasize too much the possibility that the proposed agreement may be called in question in the future. The negotiator, who wishes to include a hardship clause in the contract, must look for an ideal balance between the desire to give this clause perfectly appropriate wording and the fear that its elaboration might be responsible for the failure of the negotiations.

In addition, each sector of the economy, each type of contract, each negotiation has its peculiarities. A hardship clause included in a contract for the supply of crude oil will not be worded in the same way as a hardship clause in a loan agreement on the euro-dollar market. The diversity of the situations where these clauses appear is another reason why the elaboration of a model clause must be abandoned.

The foregoing analysis should rather be used as a memorandum, complemented by various suggestions and critical observations, in which drafters of hardship clauses should be able to find the elements they think are appropriate for the proposed operation, without jeopardizing the general atmosphere of the negotiations.[38]

A hardship clause can play an essential role in a long-term contract, in order to avoid that a rigourous application of the principle of sanctity of contracts leads to unbearable consequences. However, negotiators must be aware that such a clause, even when excellently drafted, will always be delicate to implement.

[38] The same approach is followed by UNCITRAL, in its *Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works*, New York, 1988, pp. 241–247. In its first edition of *Force majeure et imprévision*, Publication No. 421, 1985, the ICC also preferred not to propose a model hardship clause, but rather drafting advise (a model force majeure clause was then already proposed). In its new edition, however, the ICC now proposes model clauses for hardship as well as for force majeure (ICC Force Majeure Clause 2003 and ICC Hardship Clause 2003).

CHAPTER 10

"ENGLISH CLAUSES," MOST-FAVORED CUSTOMER CLAUSES AND FIRST-REFUSAL CLAUSES IN INTERNATIONAL CONTRACTS

I. INTRODUCTION

This chapter bridges the two preceding ones, dealing with two situations (*force majeure* and hardship) where the occurrence of new circumstances leads to reconsideration, and often to re-adaptation of the contract, and Chapters 12 and 13, which will examine the termination of the contract, and its survival through certain obligations that continue to bind the parties beyond the achievement of the main purpose of the agreement.

So-called "English clauses" and most-favored customer clauses provide for the re-adaptation[1] (and sometimes the termination) of the contract when market conditions have changed: either one party has received a more favorable offer from a third party, or the other party has offered more favorable terms to a third party. As for a party benefiting from a first-refusal clause, it will be offered the preferential opportunity of jointly carrying out a new transaction with the other contracting party.

It is easy to justify analyzing these three types of clause together.

What "English clauses" and most-favored customer clauses have in common is that they make it possible to adapt the contract to meet the more favorable terms offered by or granted to a competitor. English clauses and first-refusal clauses often appear as alternatives: a supply contract, for example, may be entered into on a long-term basis with the possibility of adapting or ending the arrangements provided by an English clause or on a short-term basis with a first-refusal clause allowing new contracts to be concluded for subsequent periods. The three clauses have undeniable technical similarities, as our analysis will show, for example with regard to the problem of the comparability of terms and conditions. All three make relations between the parties depend on the actual or potential intervention of competitors.

[1] Cf. J.M. Mousseron, *Technique contractuelle*, 2nd ed., Paris, Lefebvre, 1999, pp. 599–602; W. Peter, Arbitration and renegotiation clauses, *Journ. Int. Arb.*, 1986, pp. 29–46.

The Group collected and analyzed over 50 such clauses.[2]

The successive examination of English clauses (Section II), most-favored customer clauses (Section III) and first-refusal clauses (Section IV), based on a sample of more than 60 clauses, will enable the nature and economic role of each of those clauses to be better defined, their respective structures to be examined in detail and the main pitfalls to avoid in their drafting to be highlighted. The Chapter will conclude by setting out three specific legal problems that such clauses are apt to raise (Section V).

II. ENGLISH CLAUSES

A. Definition, Economic Role

An English clause (sometimes also called "alignment clause," "competitive offer clause" or "meet or release clause") gives a contracting party A (generally a buyer) the right to rely as against the other contracting party B (the seller) on an offer from a third party that is more favorable than the terms and conditions of the current contract. If B agrees to match the competitive offer, the contract continues on the new terms and conditions. If B does not so agree, A may enter into a contract with the third party and the contract between A and B will generally be suspended or terminated.

Here is a initial example of such a clause:

> "Si en cours d'exécution du contrat, l'acheteur notifie au vendeur la réception d'une offre concurrente émanant d'un fournisseur connu et sérieux, faite à un prix inférieur au prix contractuel, toutes autres conditions (notamment de quantité, de qualité et de regularité) restant égales, le vendeur devra, dans les 10 jours de la notification par l'acheteur, rencontrer les conditions de l'offre concurrente.
>
> "A défaut d'accord avec l'acheteur, celui-ci sera libéré de l'obligation d'acheter au vendeur et le présent contrat prendra fin à l'expiration du délai de 10 jours accordé au vendeur."

Typically, an English clause will be incorporated in certain long-term contracts, in particular, supply contracts granting exclusive rights or con-

[2] Cf. J.P. Desideri, *La préférence dans les relations contractuelles*, Aix-en-Provence, 1997, pp. 49–57; M. Trochu, Les clauses d'offre concurrente, du client le plus favorisé et de premier refus dans les contrats internationaux, *I.B.L.J.*, 2002, pp. 303–320. Very little litigation is known in practice concerning such clauses; no arbitral award will be cited. This may be explained either by the fact that such clauses may be less frequent than they were in the past, or because their implementation is more apt to lead to a negotiated commercial solution than to a judicial procedure. However, the compatibility of such clauses with the rules of competition has lead to a few decisions (cf. *infra*, pp. 532–535).

cerning large quantities. They are frequent in sectors especially influenced by cycles or experiencing important price variations.[3] A buyer entering into a long-term commitment will want to be able to get the benefit of any subsequent change in market conditions, which would enable him to obtain its supplies on more favorable terms. Such clauses therefore resemble price review clauses, the review being achieved here by reference to the specific benchmark of the more advantageous competitive offer on which the buyer may rely.

But the review is not automatic. First, the other party may refuse to match the competitive offer, in which case the contract will be suspended or terminated. But the very application of such a clause pre-supposes that the third party's offer is made on terms and conditions comparable to those governing the relations between the contracting parties. This *comparability* is the most difficult problem in drafting and applying English clauses.[4]

B. Concept of a More Favorable Offer

When is it possible to say that a third party's offer is more favorable? In the simplest type of case, it might be enough to compare two prices. However, in general, the situation will be more complicated. Two offers may be made at the same price, for instance, yet differ in terms of payment arrangements. If the contract is at all elaborate, the comparison will also have to extend to each of the clauses in the contract. If these are not identical (and it is most unlikely that they would be for transactions of any size or for contracts *intuitu personae*), assessing the equivalence of terms and conditions or the more favorable character of one of the contracts becomes extremely delicate. This will also be true where the object of the contract, instead of being an everyday product, is a product with a high degree of technical sophistication, such as electronic equipment.

It is also important that the competitive offer be made by a reputable business, which is likely to meet its commitments under the same conditions as the other contracting party against whom the offer is invoked, and is likely to remain open for a sufficient period of time, unlike "spot" prices offered exceptionally for limited quantities and a short period of time.

Then again, it is desirable to rule out the risk that the alleged competitive offer has been made by a business that is friendly with the buyer and conspiring with him to artificially trigger a revision of the contact or cause it to be called in question.

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[3] Cf. J. Levy-Morelle, unpublished document (available from the authors).

[4] We shall encounter this very problem again, *mutatis mutandis*, in relation to most-favored customer clauses and first-refusal clauses.

These different requirements are difficult to translate into written clauses. Here are a few examples taken from the clauses gathered by the Working Group:

- ". . . une offre concurrente émanant d'un fournisseur connu et sérieux, faite à un prix inférieur au prix contractuel, toutes autres conditions (notamment de quantité, de qualité et de régularité) restant égales . . ."
- "an offer from a producer or from a marketing organization representing a producer of . . . of at least equal quality, under similar terms and conditions, at a price lower than the current contract price with 'Buyer,' and in a quantity not less than the total maximum quantity which 'Seller' is obliged to sell for the next contract year . . ."
- ". . . un prix (inférieur) . . . offert à (l'acheteur) pour la totalité de ses besoins par un producteur de la C.E.E., connu et sérieux, toutes autres conditions notamment de qualité, de paiement et de régularité des livraisons, étant égales . . ."
- ". . . un prix de marché normal et loyal offert à l'acheteur par un autre producteur de . . . connu et sérieux, toutes autres conditions (notamment de quantités, qualité et régularité) étant égales . . ."
- ". . . if Buyer receives from an established . . . producer in the . . . countries a *bona fide* written offer to supply Buyer its product requirements for the following year at a lower price than the . . . then current price under this contract and guarantees delivery of the yearly tonnage in such year as stated in the paragraph entitled 'quantity' and of a quality equal to that provided for in this contract . . ."
- ". . . une offre de bonne foi émanant d'une autre source sûre, indépendante du groupe de l'acheteur, pour la fourniture de biens de qualité égale dans des conditions et sur des bases comparables . . ."
- "En cas d'offres répétées faites à des concurrents ou à des clients de l'acheteur situés dans le marché européen pour des produits de qualité comparable et ce, pour des quantités substantielles et régulières . . ."

The examples cited attempt to meet the concerns raised about the characteristics that the competitive offer must have in order to be taken into consideration. A few comments are needed here. References to good faith and fairness are included to defeat offers of convenience. References to the established nature and standing of the maker of the competitive offer and to terms and conditions other than the price (quality, quantities, reliability, etc.) are designed to avoid simplistic comparisons. But the difficulties in applying these criteria in a real-life situation must not be underestimated.

C. Proof of Competitive Terms and Conditions

The question of what may constitute proof of competitive terms and conditions is also a delicate area. The buyer must obviously convince the seller of the real existence of the offer that he seeks to rely upon and put the seller in a position to assess its comparability. The most direct method is to show the seller the competitive offer. But is that not contrary to business ethics, or even—in certain sectors, by revealing the price policy of a competitor—to the rules of competition?[5] There were different opinions within the Group on that point. In any event, there is a risk that relations with the third party will be jeopardized if it comes to its knowledge that its offer has been submitted to a competitor; *a fortiori*, if it were to turn out that the offer was used only to bring about a revision of the existing contract.

One solution would perhaps be to ask a competent independent outsider to examine the competitive offer and to compare its terms and conditions. Ideally, that procedure should provide the seller with the necessary re-assurance, while ensuring the desired discretion *vis-à-vis* the offeror. But, in practice, the appointment of a competent independent outsider is bound to be problematic.[6]

Some of the clauses examined by the Group were silent on the question of proof. It probably goes without saying that the buyer cannot merely invoke a competitive offer without being in a position to prove that it exists. However, an express provision would appear to be preferable.

Yet the clauses alluding to the question of proof are not very explicit. In general, they merely require the buyer to furnish sufficient proof, usually in writing, of the third party's offer:

- ". . . Buyer must furnish satisfactory proof of said offer . . ."
- ". . . fournir une preuve écrite suffisante de ladite offre . . ."
- ". . . en fournissant (au vendeur) tout élément de preuve nécessaire . . ."
- ". . . giving evidence of such offer . . ."
- ". . . l'acheteur devra apporter des éléments de preuve convaincants en ce qui concerne tant le niveau des prix que le préjudice que ceux-ci font subir à ses activités de producteur de . . ."

Two of the clauses examined provide for the involvement of an independent party.

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[5] Cf. J. Levy-Morelle, document cited above, note 3.

[6] The problem of possible recourse to an independent assessor will be taken up again *infra*, pp. 524–527.

> ". . . so as to preserve the offeror's anonymity, the third party offer may at X's option be presented to Y through a mutually agreed independent intermediary who will vouch for the existence and validity of the offer . . ."

In another example no stipulation was made for involvement of the independent party at the stage when the competitive offer was received, but such involvement remained open as an option that the seller reserved for himself, *a posteriori*, if he did not match the offer and the contract was suspended:

> "In case Buyer suspends delivery because of having received lower offer from (country), Seller reserves the right to analyse by an internationally recognised laboratory, the first cargo or any cargo received thereafter for the tonnage substituting this contract. If the results of this analysis are inferior to the quality terms stated herein, Buyer will be obliged to immediately resume delivery under this contract."

Several members of the Group considered this clause very dangerous. What, in fact, is an "internationally recognized laboratory"? Is it possible to guarantee the objectivity of an analysis of quality? It is also observed that, under the system laid down by this clause, the buyer may find himself at an impasse in the event that he has become contractually bound to the third party, and the results of the analysis require him to resume his relationship with the seller.

D. Repercussions on the Contract

In the event that the buyer has actually received a more favorable offer from a third party, what will be the repercussions on the contract? Clauses, which give the contracting party the right to match a third party's offer, all provide a fundamental choice: either the seller agrees to match the terms and conditions or the buyer may contract with the third party. But there are different possibilities involved in each of the two choices.

Bringing the conditions into line is usually achieved by a straight modification of the price to meet that proposed in the competing offer:

- ". . . Seller shall notify Buyer whether or not it will reduce the price of . . . to meet the competitive offer . . ."
- ". . . l'acheteur serait tenu, avant d'accepter l'offre concurrente, de proposer au vendeur d'effectuer les fournitures à ce prix inférieur . . ."

Some, however, prefer renegotiation to automatic adaptation:

- "Dans cette éventualité, les parties se concerteront immédiatement en vue d'adapter le prix dans un esprit d'équité."
- ". . . les parties se concerteront en vue de rechercher des aménagements acceptables par les deux parties, le vendeur conservant en tout état de cause le droit de préférence aux conditions de l'offre concurrente."

That re-negotiation technique brings competitive offer clauses closer to hardship clauses and the reference to equity in the first example will be noted in this connection.[7] The second example contains an important guarantee for the seller since he is guaranteed preference in any event within the terms and conditions of the competitive offer.

So, if the terms and conditions are not matched, the buyer will be free to enter into a contract with the third party. But since English clauses are, in general, included in long-term contracts, to be performed in installments, the possibility to accept a third party's offer for supplies will usually be limited to a specified period, for example one year:

- ". . . Buyer shall have the right . . . to purchase said quantity of product from such producer or marketing organization making said *bona fide* offer, during the next contract year . . ."
- ". . . l'acheteur aurait le droit . . . d'accepter l'offre concurrente . . . pour les fournitures de l'année calendaire suivante . . ."

In the meantime, the initial contract will be suspended:

- ". . . this contract shall be suspended during said twelve months period."
- ". . . étant entendu que l'éxécution du présent contrat serait suspendue pour la durée de l'année calendaire suivante."
- ". . . l'acheteur aura la faculté de suspendre le contrat pendant une durée de nonante jours maximum; à l'échéance de cette période de suspension, le contrat reprendra ses pleins effets, les quantités non livrées étant purement et simplement annulées . . ."

Rather rarely, the seller's refusal to match the competitive terms and conditions triggers the definitive termination of the contract:

"A défaut d'accord avec l'acheteur, celui-ci sera libéré de l'obligation d'acheter au vendeur et le présent contrat prendra fin à l'expiration du delai de 10 jours accordé au vendeur (pour accepter les conditions concurrentes)."

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[7] Cf. *supra*, Chapter 9.

E. Procedural Matters

In order for English clauses to operate, a number of procedures need to be put in place: the parties must be given notice in a specified form within specified time limits. The buyer must give notice of the competitive offer to the seller and the seller must let the buyer know if he decides to match the offer or not. If the seller decides against matching the offer, the buyer may, if appropriate, give the seller notice of his intention to suspend or terminate the contract.

In general, it is provided that such notice is to be given in writing, possibly even by registered post. However, it seems that, in practice, notice by telephone, fax or e-mail is preferred. What time limits are involved? Notice should first of all be given when the buyer has received the competitive offer and intends to invoke the clause. Sometimes it is stipulated that such notice can only be given at a certain time of the year. More specific time limits should be given for the seller to serve notice in response, and for notice—where given—of the buyer's final decision, since further performance of the contract will depend on it. It is desirable that those time limits should be relatively short, especially if the contract is for products whose price is subject to sharp fluctuations. Some members of the group stressed the importance of stipulating very precise time limits (when they are to start, whether statutory holidays are to be included, etc.); others considered on the contrary that such time limits were only a guide.[8]

The following two examples, taken from English clauses, illustrate how notice procedures may be put in place:

- ". . . 'Buyer' must furnish satisfactory proof of said offer before the 1st February of each year.
  Within forty (40) days after receipt of said offer, 'Seller' shall notify 'Buyer' whether or not it will reduce the price of the ammonia for the next contract year to meet the competitive offer. If 'Seller' shall refuse to make such a price reduction within such forty (40) days period, 'Buyer' shall have the right, upon giving written 'Notice of Termination' within twenty (20) days after expiration of the period during which 'Seller' may meet such competitive offer, to purchase

[8] In English law, the "time is of the essence" rule requires time limits to be strictly adhered to. This is the case when it is expressly provided in the contract, when one party has notified the other of it or where it flows from the very nature of the obligation. In the view of the English members of the group, most of the time limits mentioned above (with the possible exception of that fixed for the first notice to be given by the buyer) would be strictly applied, analogous to the applicable rules to time limits for exercising an option. For the "time is of the essence" rule, see, in particular, J. Beatson, Anson's *Law of Contract*, 27th ed., Oxford University Press, 1998, pp. 476–477.

said quantity of product from such producer or marketing organization making said *bona fide* offer . . ."

- ". . . Buyer shall notify Seller in writing giving evidence of such offer, and the Seller shall notify the Buyer whether or not it will meet said lower price within 30 days after date of said notice from Buyer to Seller.
  If Seller meets such lower price it will become effective 30 days after date of notice, and this contract or any extension or renewal hereof shall remain in full force and effect; if Seller does not meet such lower price, Buyer may suspend delivery during that contract year 30 days after date of said notice . . ."

F. Constraints on the Application of the Clause

An English clause poses a threat to the normal performance of contractual obligations. The seller who consents to its inclusion in the contract will often seek to limit the frequency of its application. Several types of constraint may be envisaged.

It may be stipulated that only competitive offers, whose terms and conditions differ by a required minimum from the current contract, are allowed:

> "Si l'acheteur apporte au vendeur la preuve écrite d'une offre de bonne foi . . . à un prix de plus de X% de la parité franco destination du prix contractuel tel que défini ci-dessus . . ."

A period of grace is sometimes laid down before the buyer is entitled to rely on an existing more favorable offer:

> "If after the first two years of this contract, Buyer should receive an offer . . ."

A restriction may be placed on the frequency with which the clause may be relied upon or on the period of the year in which the buyer has the right to rely upon it.

- "Il est toutefois entendu que l'acheteur ne pourra faire état d'une telle offre concurrente qu'avant le début de chaque année civile . . ."
- "Such a notification should not be given later than 30 September preceding the calendar year of delivery . . . ; notification cannot be given more than once in any year."

The buyer may forgo his right to rely on the clause for a given period of time when the seller has matched a competitive offer:

"If Seller agrees to make such price reduction, Buyer shall not request Seller to meet another offer from any producer or marketing organization for at least another twelve months period."

As observed above, in the event that the seller refuses to match the offer, the buyer may, in general, enter into a contract with the third party only for a limited period and the initial contract is suspended in the meantime.

G. Variants of the Clause

We have just described a typical English clause, with the various provisions for its application. The Working Group discovered, however, several interesting variants.

(a) In most cases, it is the buyer who has the right to rely on a third party's competitive offer (unilateral clause). A situation where the seller reserves that same right is also possible when the seller receives a better offer from a buyer competing with the other party to the contract ("bilateral clause").

The clause below, however, does not exactly reflect that situation. It is not, strictly speaking, a competitive offer that the seller seeks to rely upon against the buyer, but rather the higher price that he successfully charges other customers.

"Suspension by Seller. If at any time covered by the period of this Agreement Seller's then prevailing Net Export Price—i.e. the price actually paid by Seller's most favored customers, excluding any exceptional rebates, discounts or allowances, etc., in arm's length export transactions, basis F.0.B. vessel port, for sale of comparable quantities of (products) under substantially similar terms and conditions, plus the cost of freight (not to be higher than the prevailing freight market price on a charter basis) and Seller's other reasonable costs, if any, for delivery Cost and Freight Free Out one port Antwerp/Rotterdam range—is greater than the then Selling Price for 180 consecutive days or more, then in that event Seller shall have the right at any time thereafter, on 90 days' written notice to Buyer to suspend this Agreement for 180 days (commencing at the end of the 90 days notice period) after which this Agreement shall terminate, unless before the end of such 180 days suspension period, Seller shall elect to meet the Selling Price, or unless Buyer and Seller shall have reached agreement for the resumption and continuation of deliveries hereunder, or unless during such 180 days period the conditions which entitled Seller to suspend shall have ended . . ."

The clause continues by providing for similar arrangements to apply in the event that the "net export price" is greater than the "selling price" for 270 days or more, consecutive or not, and also for the automatic replacement of the "selling price" by the "net export price" in the event that the difference between the two exceeds a given percentage; in such a case, the buyer may elect to suspend the contract.

(b) Another clause examined by the group enables the buyer to rely against the seller on more favorable offers made by third parties not to himself, but to his competitors or to his customers:

> "En cas d'offres répétées faites à des concurrents ou à des clients de l'acheteur situés dans le marché européen pour des produits de qualité comparable et ce, pour des quantités substantielles et régulières et à des niveaux inférieurs d'au moins X% du prix du présent contrat, l'acheteur aura la faculté de demander—pour une période n'excédant pas trois mois—la suspension de l'application de la formule et son remplacement par un prix forfaitaire s'approchant du prix concurrent.
>
> "Afin de pouvoir valablement se prévaloir de cette faculté, l'acheteur devra apporter des éléments de preuve convaincants en ce qui concerne tant le niveau des prix que le préjudice que ceux-ci font subir à ses activités de producteur de . . ."

(c) Finally, a clause giving the other contracting party the right to match a third party's offer is sometimes combined with a most-favored customer clause.

III. MOST-FAVORED CUSTOMER CLAUSES

A. Definition, Economic Role, Comparison With English Clauses

By means of a most-favored customer clause, a contracting party undertakes to offer to the other contracting party the same most favorable conditions which it would offer to a third party under a similar contract.[9]

[9] This clause, examined here in its application to international contracts, is also familiar to specialists of public international law, since it is commonly stipulated in international treaties as "most-favored nation clause"; GATT (Article I), GATS (Article II) and TRIPS are the most significant examples. The clause is also to be found in cases concerning international investments; cf. e.g., the ICSID award of June 27, 1990, *Asian Agricultural Products Ltd. (AAPL) Hong Kong v. Republic of Sri Lanka*, 30 *J.L.M.*, p. 580, *ICSID Review Foreign Invest. Law J.* 1991, p. 526, *Yearb. Comm. Arb.*, XVII, 1992, p. 106.

Here is an example of such a clause:

> "Dans le cas où le fournisseur serait amené à consentir à d'autres clients des conditions qui, dans leur ensemble, seraient plus favorables que celles prévues au présent contrat pour des quantités et une qualité comparables, le fournisseur s'engage à en faire bénéficier le client à compter du jour de leur application à un tiers."

In common with English clauses, most-favored customer clauses are to be found in some long-term supply contracts. But the group also encountered some examples in sales concession and in technology transfer contracts.[10]

The purpose of such clauses is also to enable a long-term contract to be adapted to changes in market conditions in order to avoid that one of the contracting parties finds itself at a disadvantage in relation to its competitors. However, the event, which triggers the application of the most-favored customer clause, is not the same as it is in the case of an English clause. Take, for example, a contract between A and B; A may, in the first case, require the terms and conditions of the contract to be brought into line with an offer that he has personally received from a third party (competitive offer), and in the second case A may require that they be brought into line with terms and conditions that B has granted to a third party (most-favored customer).

Most-favored customer clauses therefore provide for the contractual terms and conditions to be adapted. Unlike clauses giving the other contracting party the right to match a third party's offer, it does not appear, in contractual practice, to confer a right to refuse to match the other offer or to lead to the suspension or termination of the contract.

The substantive analysis of most-favored customer clauses that follows shows, however, that they have a number of characteristics in common with English clauses.

B. Comparability of Terms and Conditions

The beneficiary of a most-favored customer clause is entitled to require that its contract be brought into line with more favorable terms and con-

[10] Cf. J.M. Deleuze, *Le contrat de transfert de processus technologique*, Masson, 1976, pp. 58–59, 137–138. The law and practice of co-insurance also reveals the existence of "most-favored insurer clauses": the insured promises the insurers willing to enter a co-insurance scheme on the basis of certain terms that they will benefit from the more favorable terms the insured would grant to newcomers (cf. E. Peña Triviño, Comentarios sobre la clausúla del reasegurador mas favorecido, *Rev. Ibero-Latioamericana de Seguros*, 2003, pp. 233–242.

ditions that the other party to the contract may have granted to third parties. But how is the "more favorable" nature of such terms and conditions to be assessed? The problem of comparability arises here in the same way as it did in the case of English clauses.

Sometimes the contracting parties are not at all aware that this problem exists (or that the other difficulties described below exist), merely stipulating that

> ". . . le vendeur appliquera à l'acheteur pendant la durée du contrat la clause du client le plus favorisé."

Such a rudimentary clause is clearly to be eschewed. It paves the way for all sorts of possible disputes.

It is important at least to specify whether the comparison will extend only to prices or whether the contractual terms and conditions, as a whole, will be taken into consideration.

A standard clause designed to be included in a licensing contract implicitly refers to the alternative by specifying, in parentheses, that only royalties may be examined in making the comparison:

> "If at any time hereafter the licensor shall grant a licence to another on more favorable terms (as to royalty) than are granted to the licensee hereunder . . ."

It is rare, however, that the parties would have the application of the clause depend only upon a comparison of the respective prices. The clauses of a contract form an indivisible whole. A lower price may be due to other terms and conditions relating to quality, delivery times, methods of payment, the duration of the contract, whether there are any linked agreements, etc. The wording of most-favored customer clause generally refers to all the terms and conditions of the contract that is claimed to be more favorable, while possibly referring explicitly to one or more of those terms and conditions:

- "In the event that A shall hereafter grant any third party a licence . . . at royalty rates lower than the rates specified in article III hereof by an agreement containing substantially the same terms and conditions as this agreement . . ."
- "Der Auftragnehmer gewährleistet hiermit, dass die im Vertrag enthaltenen Preise und die während der Laufzeit des Vertrages anzubietenden Preise fair und angemessen sind und den Preisen entsprechen, die nach der Meistbegünstigungsklausel des Auftragnehmers für gleiche Artikel unter vergleichbaren Bedingungen und Umständen gezahlt werden."

- "Le contractant garantit que les prix fixés ci-devant ne sont pas plus défavorables que ceux que, ramenés à des circonstances comparables, il accorde à tout autre acheteur national ou étranger, gouvernmental ou privé . . ."
- ". . . Licensee shall be entitled to the benefit of such lower licence fees . . . only for so long and to the extent and subject to the same conditions that such lower licence fees shall be available to such other licensee, provided however that licensee shall not be entitled to such lower licence fees without accepting any less favorable terms that may have accompanied such lower licence fees . . ."
- "Dans le cas où le fournisseur serait amené à consentir à d'autres clients des conditions qui, dans leur ensemble, seraient plus favorables que celles prévues au présent contrat pour des quantités et une qualité comparables . . ."
- "Le vendeur garantit à l'acheteur le traitement du client le plus favorisé, toutes autres conditions de livraison (notamment de quantités, qualité et régularité) étant égales . . ."

In some of these clauses it is possible to identify, *inter alia*, a concern to avoid taking into consideration more favorable terms and conditions, which have been granted to a third party in exceptional circumstances, for example, for a very limited transaction.

However, what is not seen here is the concern to avoid connivance with third parties that sometimes underlies English clauses. The most-favored customer clause only applies in situations where one of the parties to the contract concludes a contract on more favorable terms with a third party; it is difficult to see how, in that context, that contracting party could gain some benefit from any possible connection with the third party.

C. Proof That More Favorable Conditions Have Been Granted

There is a danger, however, that the contracting party in question will avoid revealing to the other that it has granted more favorable terms to a third party. In the case of an English clause, the buyer could be trusted to produce any such offer spontaneously since the result would be that the contract would be adjusted to his benefit. The problem there was verifying that the alleged offer actually existed and checking its *bona fides* and substance. Here, the circumstances are very different. The most-favored customer clause operates to the detriment of the party that has entered into a contract with a third party; the concern here is that that party will seek to hide the fact that the new contract has been concluded. The original contracting party will therefore need to be provided with some means of investigation in order to avoid such a fraud.

Some most-favored customer clauses fail to face up to this problem and deal with it, providing nothing as regards the manner in which the contracting party is to be informed of the more advantageous conditions granted to a third party. It is sometimes simply stipulated that the party, who has contracted with a third party, undertakes to inform the original contracting party, but without laying down any specific method of checking. Such clauses risk becoming dead letters unless there is a well-established relationship of trust between the parties.

A first step is made where the clause requires proof to be produced at any time showing that no third party is getting the benefit of more favorable conditions. But such proof can truly only be furnished by directly checking the books and accounts of the party concerned. Some of the clauses examined by the group provide for such a check, which is to be carried out either by representatives of the contracting party itself or by an independent assessor:

- "Der Auftragnehmer ist bereit dem Auftraggeber auf schriftlichen Antrag den Beweis für die Richtigkeit dieser Versicherung während der Laufzeit dieses Vertrages zu erbringen und von Beauftragten des Auftraggebers im Betrieb des Auftragnehemers nachprüfen zu lassen."
- "Alpha s'engage à produire, à la demande de Béta, la preuve de l'observation des assurances données au premier alinéa du présent article. A cet effet, elle remettra à Beta une attestation écrite établie par un contrôleur économique indépendant qui aura pu prendre connaissance des documents commerciaux essentiels lui permettant de remplir sa mission. Cette procédure ne doit pas occasionner de dépenses supplémentaires à Béta."
- "Der Auftragnehmer verpflichtet sich, dem Auftraggeber die Einhaltung der . . . gegebenen Zusicherungen auf Verlangen nachzuweisen. Zu diesem Zweck wird Auftragnehmer nach Wahl des Auftraggebers entweder dessen Beauftragten Einsicht in alle hierfür wesentlichen Geschäftsunterlagen gewähren, Abschriften daraus anfertigen lassen sowie alle erforderlichen Auskünfte erteilen oder die schriftliche Bestätigung eines unabhängigen Wirtschaftsprüfers vorlegen. Hierdurch dürfen dem Auftraggeber keine zusätzlichen Kosten entstehen."[11]

D. Repercussions on the Contract

Where it is established that more favorable terms and conditions have been granted to a third party, the beneficiary of the most-favored customer

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[11] As regards possible involvement of an "independent assessor," cf. *infra*. pp. 524–527.

clause may, in principle, require the contract to be brought into line with those more advantageous terms and conditions:

> ". . . then licensee shall be entitled to the benefit of such lower royalty rates . . ."

It is important, however, to specify the precise moment from which the contract is to be amended. The most common solution seems to be that the new terms and conditions are to apply from the date when the third party benefited from more favorable terms and conditions, possibly together with a provision for the reimbursement of any overpayment made in the meantime, but with no retroactivity for the earlier period. The clauses examined, however, were not always drafted as tightly as they could have been:

- ". . . les prix fixés ci-avant seraient réduits en conséquence et les sommes payées en trop seraient remboursées."
- ". . . Buyer shall immediately be given a price and/or terms no less favorable."
- ". . . le fournisseur s'engage à en faire bénéficier le client à compter du jour de leur application à un tiers."
- ". . . Licensee shall be entitled to the benefit of such lower royalty rates on all operations thereafter conducted under this Agreement; provided, however, that such lower royalty rates shall not apply retroactively for Licensee nor shall this Article . . . be construed to entitle Licensee to any rebate or reduction with respect to royalties paid or due by it prior to the grant by A of such lower royalty rates to such third parties . . ."

The clauses quoted above merely provide for the contract to be automatically brought into line with the competitive terms and conditions. Although the Group did not find any example of this, it is possible to envisage that, in sufficiently elaborate contracts, the adjustment should be the subject of negotiation.

Furthermore, as we have seen, it does not appear that refusal to adjust the contract is an option under most-favored customer clauses as it is under clauses giving the other contracting party the right to match a third party's offer. Without doubt it would be difficult to refuse to grant to the original contracting party terms and conditions that have just been granted to a third party.

E. Procedural Matters

The procedure for implementing most-favored customer clauses is simpler than that for English clauses, since the former do not entail a number of possible choices.

It is simply a case of ensuring that notice of the conclusion of a more favorable contract with a third party is given. The principal aspects of this problem have been considered above in relation to proof and verification. Doubtless, the clause may also stipulate that notice must be given within a short period of the conclusion of the contract with the third party:

- ". . . si le contractant accordait des conditions plus favorables à d'autres clients, il en aviserait immédiatement l'Administration . . ."
- ". . . then Licensor shall notify Licensee promptly of such lower licence fees . . ."

One question, which should perhaps be the subject of a special procedure in certain cases, is what happens when there is a difference of opinion between the parties as to whether the terms and conditions granted to the third party are more favorable. The clause below contemplates that situation but does not specify the method of settling the dispute:

> "Lehnt der Auftragnehmer nach Vertragsabschluss die Anwendung dieser Meistbegünstigungsklausel auf bestimmte Verträge mit Dritten ab, weil er die diesen Verträgen zugrundeliegenden Kostenverhältnisse nicht mit den Verhältnissen dieses Vertrages für vergleichbar hält, so verpflichtet er sich, diese Verträge dem Auftraggeber unverzüglich schriftlich anzuzeigen und seine Auffassung zu begründen."

If the dispute persisted, the general arbitration clause of the contract would certainly be invoked.

F. Constraints and Limits on the Application of the Clause

The types of constraint on English clauses being used too frequently, which we saw above, do not appear to have a practical counterpart in the case of most-favored customer clauses. One could, however, conceive of a provision requiring a minimum difference to exist between the contractual terms and conditions and those granted to a third party before the terms and conditions had to be matched.

A geographical limit is sometimes applied to the clause. In view of the great differences, which may exist between markets and the extent of the activities of the beneficiary of the clause, it may be provided that only more favorable terms and conditions granted to companies in certain specific countries are to be taken into account:

> "In the event that A shall hereafter grant any third party a licence under the Patent Rights of A in any of the following countries (Austria, Belgium, Denmark, Finland, France, West Germany, Great Britain, Ireland, Italy, Luxembourg, The Netherlands, Norway, Portugal, Spain, Sweden and Switzerland) . . ."

G. Variants of the Clause

(a) In one very specific case, the group found a clause similar to a most-favored customer clause in the context of a stipulation laid down for the benefit of a third party.

A number of manufacturers of aircraft equipment simultaneously negotiated for the supply of aircraft with several governments. One of those governments concluded a contract with one of the companies, and it stipulated in the contract on behalf of the other governments concerned that the company in question would not impose less favorable conditions on those other governments than those granted to itself: instead of arranging for itself to have the right to benefit by any advantages that might subsequently be granted to a third party, the contracting party made provision for third parties to get the benefit of advantages that it itself obtained. The mechanism is, in a sense, reversed:

> "Dès à présent, les Preneurs d'ordre s'engagent, lors de la conclusion de pré-contrats et/ou contrat définitif avec (les pays X, Y et Z) . . . de ne pas exiger de ces Gouvernements, des stipulations plus défavorables que celles accordées au Donneur d'ordre, dans le cadre du présent contrat, ou celles qui seraient convenues lors de la passation de pré-contrats et/ou de contrats définitifs ultérieurs."

That clause goes on to refer to the terms and conditions of a contract already concluded between another company and another government, and stipulates that the buyers are not to impose less favorable conditions either on the purchaser or on other governments:

> "D'autre part, les Preneurs d'ordre s'engagent, lors de la conclusion d'un contrat principal avec le Donneur d'ordre et/ou les Gouvernements (des pays X,Y et Z), de ne pas exiger des stipulations plus défavorables que celles consenties par la firme . . . , dans ses contrats passés avec le Gouvernement (du pays Z) et le Donneur d'ordre et, relatifs au même objet contractuel."

(b) A most-favored customer clause is sometimes combined with an English clause. Here is an example:

> "B undertakes to give P most favorable price treatment in (country X) for their requirements within the market of (country X) . . . , that is to say that B will supply the Agreement products to P at prices no higher and under conditions no less favorable than those at and under which the same products of equal quality are supplied by B to any customer in (country X) . . .

"If P receives from elsewhere a *bona fide* offer from a third party which in respect of quality and/or price and/or other conditions is more favorable than B's offer, P will invite B to offer equivalent terms. B shall have a period of one month from the date of submission of the third party offer either to meet or to refuse to meet the terms and conditions of said offer . . .

"If B refuses to meet or fails to advise P of its decision within said period of one month . . . , P shall be released from their obligation to purchase agreement products from B, but only in respect of a quantity thereof which is equivalent to the quantity of comparable products which have been offered to P by the third party under terms more favorable than those of B."

Party P therefore gets all the advantages. It will benefit from the more favorable conditions that contracting party B grants to a third party, and it may ask B to match the more favorable conditions that P might be offered by a third party. If the state of the market were to alter, it is even conceivable that the two situations might arise simultaneously and P could rely on the more advantageous clause of the two.

In another case examined, the two clauses do not operate in favor of the same party, but one is granted to party A whereas the other operates in party B's favor, A and B having agreed on an exclusive mutual supply agreement. That arrangement is proposed in the following letter:

"Messieurs,

"Voulant reconnaître l'effort fait par votre société de nous fournir les quantités de (produit X) nécessaires à nos fabrications alors que règne une grande pénurie de matières sur le marché, compte tenu aussi des prix favorables qu'en cette période vous maintenez vis-à-vis de nous, notre société a décidé—à partir de ce jour—de vous accorder pendant un terme de cinq ans, la priorité de fourniture de (produit X) pour la couverture de nos besoins normaux tels qu'ils vous sont connus (environ . . . par mois).

"Cette exclusivité d'achat que nous réservons à vos usines est subordonnée à la condition que vous continuiez à nous remettre des cotations basées sur les prix internationaux pour des tonnages équivalents.

"Nous ne pourrions acheter ailleurs que lorsqu'après vous avoir avisés de ce que votre cotation est plus élévée—toutes conditions égales, vous auriez refusé de réduire votre prix au niveau de celui

prévu; cette décision devant nous être signalée par écrit dans les 24 heures ouvrables de la communication dont question.

"D'autre part, nous vous avez donné l'assurance que c'est chez nous que vous vous approvisionnerez en produits Y de notre fabrication dont vous pourriez avoir besoin pour votre usage personnel; dans ce cas, nous nous engageons à vous donner priorité de livraison et ce, au prix de notre client le plus favorisé.

"Veuillez agréer, Messieurs, nos sincères salutations."

IV. FIRST-REFUSAL CLAUSES

A. Definition, Comparison With Other Clauses

By a first-refusal clause (or preferential treatment clause, pre-emption clause), party A undertakes to offer the beneficiary, party B, the opportunity in future to conduct a particular transaction jointly before concluding such transaction with a third party. In the event that B refuses, A is once again free to contract with some other party.[12]

Here is a first example of such a clause:

"If and to the extent that in any year or quarter A should have requirements of . . . products or both in excess of the quantities otherwise deliverable hereunder in that year or quarter, B shall have the first option (to be exercised within thirty (30) days of receiving due and proper notice thereof) to supply on the terms and conditions hereof. If B does not exercise the option to supply any or all of such excess, A shall be free to purchase the deficit elsewhere."

When it concerns a sales contract, the first refusal clause is often called "pre-emption clause."

In order to get a better idea of the scope of first-refusal clauses, they should be compared with options and examined in comparison with English and most-favored customer clauses.

(a) How Does a First-Refusal Clause Differ From an Option? A party granting an option, after having proposed to conclude a contract with

[12] For this clause, see J.M. Mousseron, *op. cit.*, pp. 77–86, as well as J. de Visscher's old, but still relevant, study, *Le pacte de préférence*, Brussels and Paris, 1938, 241 pp. The author pays particular attention to the applications of the clause to sales of real property and share issues. Also see the examples provided in D. Fosbrook & A.C. Laing, *The A–Z of contract clauses*, London, Sweet & Maxwell, 1997, Vol. First Refusal, pp. 152–153.

another party, undertakes to keep its offer open in favor of that party alone for a certain time. During that time, the beneficiary may exercise the option, in which case the contract is immediately and automatically concluded. In French law, the option itself is a contract, since it is the outcome of a meeting of the minds between the parties even though it creates only an obligation for one of the parties (it is a unilateral contract).[13] In English law, an option is, in principle, not binding in the absence of consideration, although consideration may take the form of the payment of a nominal sum, for example £1.[14]

Like a first-refusal clause, an option confers a preference on the beneficiary as compared with third parties with regard to the conclusion of a contract. But there are at least two differences:

An option applies to a transaction that has been decided upon. I am prepared to sell you my house and I give you an option to buy it. I therefore hold myself in readiness to carry out the transaction if you exercise the option. If not, although I am not obliged to, I will, in all probability, seek to enter into a contract with a third party.[15] A clause of first refusal, in contrast, relates to a transaction that may or may not be carried out in the future. If, one day, I decide to sell my house, I undertake to give you first refusal. But it is possible that I will never put my house on the market. An option immediately comes into force whereas a first-refusal clause may remain a dead letter.[16]

Furthermore, an option is granted on the basis of a complete, specific contractual offer, with the result that if the option is exercised, this triggers the immediate and automatic conclusion of the contract. Given the future

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[13] See J. Ghestin, *La formation du contrat, Traité de droit civil*, 3rd ed., Paris, L.G.D.J., 1993, pp. 300–305.

[14] See J. Beatson, *Anson's Law of Contract, op. cit.*, pp. 53–55.

[15] The operation can take place immediately (my house is for sale) or only in the future (leasing contracts include a purchase option that can be exercised at the end of the lease), but, in any case, the party granting the option agrees as of now to conclude the operation.

[16] Compare Halsbury's Law of England, *Contracts*, para. 236: "Similar to the contract of option is the contract of "first refusal" or "pre-emption," whereby one person enters into a contract with a second which provides that if the first person contemplates entering into a certain defined contract or type of contract with anyone, he will first offer to do so with that second person. That type of contract differs from the contract of option in that the first person has made no positive offer; his duty will usually be the purely negative one of not contracting with any third person on the defined respect unless and until he has first offered to do so with the second person; but it is conceivable that his duty may merely be that, if he does so contract with any third person, he will make that contract subject to the second person's right of first refusal"; cf. also M. Anderson, *A-Z Guide to Boilerplate and Commercial Clauses*, London, Butterworths, 1998, pp. 141–142.

and contingent nature of the envisaged operation, a first-refusal clause does not normally have those characteristics. When and if it operates, the conditions will have to be negotiated. Accordingly, several different situations must be distinguished.

On top of this, the terminology used, in practice, is not always fixed and the two expressions "option" and "first refusal" are sometimes used one for another or interchangeably.

The Group's analysis exclusively covered true first-refusal clauses.

(b) The distinction between first-refusal clauses and English clauses is easier to establish. The first type of clause covers the grant of preferential treatment for the conclusion of a new transaction (first refusal) and the second type enables the terms and conditions of a contract to be brought into line with a third party's more favorable offer (competitive offer). It is hardly possible to confuse the two.[17] There are several problems common to these types of clauses.

We have already noted that, in certain circumstances, these clauses could be alternative procedures: a firm wanting to meet its supply requirements, but concerned always to do so on market terms, may either conclude a long-term contract with an English clause or else a short-term contract with a first-refusal clause for the conclusion of subsequent contracts.

(c) Most-favored customer clauses are likewise different from first-refusal clauses since, as in the case of English clauses, they also enable a current contract to be modified by reference to more favorable conditions, which have emerged in the relations between one of the parties and a third party, and do not grant a preference with regard to the conclusion of a new transaction. However, as we shall see, there are several features of the application of first-refusal clauses that resemble those discussed in connection with most-favored customer clauses.

B. Economic Role

Whereas English clauses and most-favored customer clauses generally have the same principal aim of enabling a long-term contract to be adapted in accordance with changing market conditions, first-refusal clauses would appear to serve much more varied economic purposes. The following few cases illustrate some of those purposes.

Case No 1. A supply contract is concluded between two firms. The contract is for certain pre-determined quantities, beyond which the parties are,

[17] These clauses are however confused with each other in *Clunet*, 1974, p. 796, when defining first-refusal clauses.

in principle, free to deal elsewhere. It is, however, provided that, for additional quantities, one of the parties should grant the other priority before that party enters into a contract with a third party.

The clause quoted at the start of this review of first-refusal clauses corresponds to that situation. Preference was given to the seller in the event of the buyer having additional requirements. Conversely, such a clause may give the buyer preference when it comes to purchasing any of the seller's excess production:

> "In the event that Sellers in the first of 15 years of the Delivery Period can deliver from the Reservoirs from the . . . pipeline at the X terminal larger gas quantities than stipulated in paragraph 3.1, Buyers shall have the right to purchase such quantities if Buyers so desire . . ."

Case No 2. Two businesses collaborate in the development of a product. One of them gives the other the benefit of a first-refusal clause with respect to the purchase of basic materials and products:

> "Compte tenu de la spécificité des matériels et des produits nécessaires à l'utilisation des dispositifs, X consultera Y pour l'acquisition de tels matériels et produits de base. Si, pour des caractéristiques équivalentes, les conditions offertes par Y pour leur fourniture sont de même ordre que celles des offres de la concurrence techniquement les plus proches, X s'engage à réserver à Y la priorité pour la fourniture desdits matériels et produits de base."

Case No 3. Firm A grants a manufacturing licence to a foreign partner B. To cover the event that B should consider exporting part of its production to another country Z, B grants firm C, a subsidiary of A in country Z, the right of first refusal regarding the distribution of products in that country.

> "Dans tous les cas où B exportera du pays X vers le pays Z, des véhicules B et/ou des pièces de véhicules B fabriquées par B, en vertu des présentes, B devra proposer d'abord la vente des véhicules B et des pièces de véhicules B à la firme C, ou telle autre société qui aurait le droit d'agir comme distributeur des produits A dans le pays Z.

> "Si B et C, ou cette autre société, n'étaient pas d'accord sur l'ensemble des conditions et modalités d'un contrat de distribution, B aura alors la liberté de proposer un tel contrat à tout autre personne, entreprise ou société, à condition cependant que B ne propose pas par la suite à cette personne, entreprise ou société, des clauses ou conditions plus favorables que celles offertes à C, ou

tout autre société, qui aurait le droit d'agir comme distributeur des produits A dans le pays Z . . ."

Case No 4. A wishes to purchase a building belonging to B. B does not intend to sell it at that time, but B agrees to a clause giving A first refusal in the event that B should change its mind:

"1. In consideration of . . . paid by the grantee to the owner (the receipt whereof the owner hereby acknowledges) the grantee shall have the right to purchase the property known as [parcels] . . . if the owner shall desire to sell [or otherwise dispose of] the said property or any part of it within a period of twenty-one years.

"2. The owner shall give written notice to the grantee of his desire to sell the said property and the grantee shall within two months of the receipt of such notice give written notice (hereafter called the option notice) to the owner of his desire to purchase the property, then the following terms shall take effect.

. . .

"5. If the grantee does not serve the option notice within the time prescribed by clause 2 . . . then the owner may deal with or dispose of the property free in all respects from the rights of the grantee . . ."

Case No 5. Under an underwriting contract a company grants a banking consortium a right of first refusal over any subsequent issues:

"Au cas où la société émettrait plus tard d'autres emprunts en Suisse, elle donnera aux banques un droit de préférence, à conditions égales, pour la prise ferme de ces emprunts."

Case No 6. X and Y are considering the possibility of setting up a joint venture with a view to constructing a factory and producing a certain product. Feasibility studies are under way. X is hesitant and fears that an agreement will not be reached. But X wants to be in a position to change its mind should Y subsequently enter into negotiations with a third party.

"Both parties agree to carry out the additional feasibility study within 3 months and to take their decision as to the establishment of the joint venture and for its plant construction and production schedule before December 1, 20 . . .

"In case it is not decided at such date to establish the joint venture and to proceed with its plant construction and production schedule, Y will be free to negotiate with a third party provided that,

until February 28, 20 . . . , X will have a priority right to be exercised within one month from the date of notice that Y intends to enter into concrete business talk with a third party for the manufacture of the product."

Case No 7. A mining or oil prospecting syndicate is contemplating the eventuality that unanimous agreement cannot be reached with regard to prospecting in a particular area. In that event, the partner or partners wishing to proceed with the prospecting may do so alone (these are known as "sole risk clauses"), provided, however, that they first give the other partners in the syndicate the opportunity of joining in with them.

"8.1. Si l'ensemble des associés dans le syndicat considère une zone comme méritant d'être développée, il constituera une S.E.P. qui pourra utiliser les résultats obtenus. Si la S.E.P. juge qu'il est de l'intérêt commun de prendre des permis de recherche ou d'exploitation, les caractéristiques de ces permis seront déterminées d'un commun accord. A cet effet, la S.E.P. mandatera son gérant.

"8.2. A défaut d'accord de l'ensemble des associés dans le syndicat, comme prévu en 8.1., il est convenu que si, à tout moment, un ou plusieurs des associés (ci-après désigné par le ou les requérants(s)) souhaite(nt) sur une de ces zones effectuer des travaux complémentaires et demander un titre minier de recherche ou d'exploitation, il (ou ils) devra (devront) en informer préalablement les autres associés dans le syndicat et leur proposer de s'associer à eux pour l'éxécution des travaux complémentaires et pour ladite demande. Les associés ainsi informés devront faire connaître dans un délai de deux mois à compter de la notification qui leur aura été faite, leur décision de s'associer ou non au projet (programme, budget) présenté par le ou les requérant(s). En cas de réponse négative de certains des associés, ceux-ci ne pouvant s'opposer à la réalisation de ce projet, le ou les requérant(s) pourront faire appel à des concours extérieurs pour ladite réalisation.

"Les droits des associés dans le syndicat qui ne poursuivront pas, feront alors l'objet de négociations entre les associés."

Case No 8. In the event that a joint venture is wound up, it is agreed that certain participants will have a right of first refusal before others and before third parties for the purchase of certain assets.

"In the case of an asset of the Company situated in or in close proximity to either the Assets (A) or the Assets (B), then A and B shall respectively have a right of priority against the other and shall

procure for such other a right of priority against third parties to purchase such asset."

Case No 9. The statutes of a joint venture provide for a preferential right for the participants in the event that one of the members should decide to sell its shares.

"A Participant may offer to sell all of the shares owned by it and its Affiliate(s) in both Companies to a specified third party or all or part of such shares to one or more specified Participants holding shares in such Companies provided that the Participants other than the offeror holding shares in those Companies are first given an opportunity to purchase the shares on the same terms and conditions as offered to the third party or the specified Participant(s). . . ."

These few examples, which are far from exhaustive,[18] give an illustration of the variety of situations in which first-refusal clauses may operate.

Readers will note that Case No. 9, concerning preferential rights for partners in the case of a sale of shares, reflects a situation that, to a certain extent, is not covered by freedom of contract in many countries. Often, company law lays down binding rules governing the participants' rights in such situations.[19] The same is true of the preferential rights generally conferred upon existing shareholders in the event of an increase in capital.

Apart from the variety of situations encountered, one characteristic common to most first-refusal clauses emerges: in common with English and most-favored customer clauses, they are usually found in situations where the contracting parties have relatively long-standing trading links. Various transactions have been carried out jointly and may still be being carried out, and the parties will be seeking to collaborate again in the future.

C. Provisions in First-Refusal Clauses, Comparability and Verification

First-refusal clauses may be organized in a variety of ways.

(a) An initial distinction should be made on the basis of the different possible time sequences for offers made to B and offers made to third par-

[18] Concerning first-refusal clauses as a means of solving disputes resulting from deadlock situations in joint ventures, cf. the chronicle of the working group on international contracts published by F. De Ly, Les clauses de divorce dans les contrats de groupement d'entreprises internationaux, *I.B.L.J.*, 1995, pp. 299–313.

[19] Cf. the national reports published with the chronicle cited in the preceding note, pp. 316–345 (Belgium: P. Hubert; France: B. Mercadal; Germany: W. Kraft; The Netherlands: W.J.H. Wiggers; England: P. Ellington; Spain: J. Richter; the United States: E. Klopfer; Switzerland: J. Revaclier), as well as L. Bellodi's report on European law.

ties. In some cases, A must first offer the transaction to B before embarking on any negotiation with third parties; in other cases, A may seek offers from third parties provided that he does not accept any of them before having first offered to enter into a contract with B on the same terms and conditions.

The following two examples illustrate these two cases:

- "Au cas où X serait en mesure de vendre plus de 5 000 tonnes de produits du contrat dans le territoire au cours d'une année et si Y ne pouvait fournir le tonnage supplémentaire aux conditions du présent accord, X serait alors libre d'acheter à des tiers les quantités que Y ne pourra lui fournir."
- "Subject to the requirements of Paragraph 25 hereof, if any Party receives a *bona fide* offer which it is willing to accept for the purchase of all or a percentage of such Party's undivided interest in the License Area, from a person, firm or corporation ready, able and willing to purchase such interest, the Party receiving said offer shall give written notice thereof to each of the other Parties, including in said notice the name and address of such offeror, the price offered and all other pertinent terms and conditions of the offer. The other Parties, for a period of sixty (60) days after the receipt of said notice, shall have the prior and preferred right and option, in the ratio of the respective Percentages of Interest of those electing to purchase, to purchase the interest covered by said offer at the price and according to the terms and conditions, specified in said offer . . ."

Sometimes, the two systems are found in conjunction. A must first offer the transaction to B. If B refuses, A may turn to a third party, but before accepting any offer, it must once again offer the contract to B on the same conditions as the third party's offer.

> "In case it is not decided at such date to establish the joint venture and to proceed with its plant construction and production schedule, Y will be free to negotiate with a third party provided that, until February 28, 19 . . . , X will have a priority right to be exercised within one month from the date of notice that Y intends to enter into concrete business talk with a third party for the manufacture of the product."

Some of these clauses provide that if B refuses the contract, A will be free to enter into a transaction with a third party only for a certain period of time, after which B's preferential right revives:

> ". . . If A fails to accept said offer or to complete said sale within said period of six (6) months, the preferred right and option of B

under the preceding sub-paragraph (a) of this Paragraph 24 shall be considered as revived, and A shall not complete said sale to said offeror unless and until said offer again has been presented to B, as hereinabove provided, and B again has failed to elect to purchase on the terms and conditions of said offer . . ."

(b) First-refusal clauses also differ as regards A's degree of freedom to seek another contracting party in the face of a refusal from B. Is A free to trade with a third party on any terms and conditions, or may A only enter into a contract on terms and conditions similar to those which B has just refused?

In the absence of an express provision in the clause, the problem is a very delicate one.

In one sense, it can be argued that to give A complete freedom to negotiate with the third party would be likely to render the first-refusal clause illusory. To render B's preferential right nugatory, it would suffice for A to offer B unacceptable contractual terms and conditions and then offer normal ones to the third party.

But on the other hand, would A not be subject to an unacceptable restriction if B's refusal constrained his room for maneuver to that extent in any subsequent negotiations with third parties?

It seems that parties should be guided by the following principles in the absence of any express provisions: A should be contractually liable if he sought to render B's preferential right illusory by proposing manifestly unacceptable conditions to B. In contrast, where B has refused normal terms and conditions, A should not necessarily be obliged to propose identical terms and conditions to a third party, but if negotiations with the third party were leading to clearly more favorable terms and conditions, A should make B a new offer on the basis of those modified terms and conditions before entering into a contract with the third party. These guidelines may be based on the principle of French law that contractual obligations should be performed in good faith and on the doctrine of "implied terms" in English law.

Those drafting first-refusal clauses have an obvious interest in eliminating this potential source of litigation by specifying, in express terms, what is to be the relationship between the respective terms and conditions offered by A to B and to third parties. Of the clauses examined, some contained solutions to aspects of this problem.

Sometimes, the clause granted complete freedom:

> "If the company shall not within the period of two months aforesaid find a purchaser for the share and give notice as aforesaid, the vendor shall at any time within three months after the expiration of the said two months be at liberty . . . to sell the share to any person and at any price and transfer the same accordingly . . ."

Where the clause relates to the possible supply of additional quantities over and above those specified in a supply contract, the terms and conditions to be offered to a third party in the event of a refusal on the part of B are not necessarily specified, but reference to the terms and conditions of the existing contract should, as far as the prior offer to B is concerned, preclude the possibility of an unacceptable offer being made (unless the terms and conditions no longer reflect market prices at all):

> "If at any time A should have a specific requirement in the Contractual Area of petroleum products other than those prescribed in Clause 5 (a) hereof B shall have the first option (to be exercised within sixty (60) days of receiving due and proper notice thereof) to supply on the terms and conditions hereof. If and to the extent that B do not exercise the option to supply, A shall be free to purchase such petroleum products elsewhere . . ."

Furthermore, where the clause allows A to receive a third party's offer before preferentially offering to enter into a contract with B, that offer from a third party also provides a basis for comparison:

- "accorder à N.V. un droit de premier refus sur l'achat de ladite unité, à charge pour N.V. d'accepter les mêmes conditions que le tiers acquéreur . . ."
- ". . . the other parties . . . shall have the prior and preferred right and option . . to purchase the interest covered by said offer at the price and according to the terms and conditions specified in said offer."

The same applies when the clause requires A, after an initial refusal, to offer once again to enter into a contract with B on the terms and conditions offered by a third party.

When the offer must be made to B before any negotiation with a third party, it is sometimes expressly specified that, in the event that B refuses, A will only be able to enter into a contract with the third party on the same terms and conditions:

> "Si A et B n'étaient pas d'accord sur l'ensemble des conditions et modalités d'un contrat de distribution, A aurait alors la liberté de

proposer un tel contrat à tout autre personne, à condition cependant que A ne propose pas à cette personne des clauses ou conditions plus favorables que celles offertes à B . . ."

The preceding considerations show that comparability also poses a problem in relation to first-refusal clauses, as it did for the two other types of preferential clause examined above. If A may not enter into a contract with a third party on more favorable terms and conditions than those which it offered to B, the respective terms and conditions will necessarily have to be compared. In several of the clauses quoted, readers will have noted that the wording is such that the comparison relates not only to the price, but to the terms and conditions as a whole. However, the difficulties in making such a comparison are well known, especially in the case of complex contracts.

There is also a problem for B when it comes to checking the terms and conditions on which A has entered into a contract with a third party after B's initial refusal. The clauses examined by the group did not give any indication as to how this point, which would certainly be very difficult to deal with in practice,[20] should be handled.

One last thought on comparability: this question is less acute where the transaction contemplated is not the conclusion of contract "at arm's length" (sale, licence, etc.) but rather possible collaboration in a joint enterprise. In such case, the determining factor will be the degree of interest in the transaction, rather than the conditions of participation.

D. Procedure

Implementing a first-refusal clause calls for a procedure to be put in place, which we will not cover in detail. As we saw in the case of English and most-favored customer clauses, it is a matter of laying down, *mutatis mutandis*, the form that the various required notices is to take and the relevant time limits: notice of A's intention to carry out the operation in question, notice of B's decision to enter into a contract with A or to refuse to do so, and, if necessary, depending on the type of clause, notice of the terms and conditions under which a third party is prepared to enter into a contract.

Many of the clauses examined by the Group failed to deal with these procedural aspects, an omission that may to give rise to practical difficulties.

However, here are two extracts from clauses that are relatively detailed as to certain procedural aspects. The first relates to the grant of a right of first refusal to co-participants of a shareholder wanting to sell his shares. The second relates to the sale of a building.

[20] For possible recourse to an independent assessor, cf. *infra*, pp. 526–527.

- ". . . Any offer of shares made pursuant to Section 6.3 hereof shall be in writing by registered letter, where feasible by airmail, shall identify the person(s) to whom the offering Participant desires to sell shares, shall contain the terms and conditions of the offer, and shall be deemed to have been rejected if not accepted within 30 days (in the case of original offers) or 15 days (in the case of subsequent offers) from the date on which such registered letter was posted . . ."
- ". . . The owner shall give written notice to the grantee of his desire to sell the said property and if the grantee shall within two months of the receipt of such notice give written notice (hereinafter called the option notice) to the owner of his desire to purchase the property then the following terms shall take effect.

  "The grantee and the owner shall attempt to reach agreement on the value of the property in the open market and with vacant possession at the time of the service of the option notice and if such agreement has not been reached within one month from the service of the option notices then an independent qualified surveyor shall be appointed to make a valuation . . .

  "Once such valuation has been agreed or made in the manner stated the grantee shall have one month in which to decide whether he wants to proceed with his intended purchase of the property at that valuation and if he shall within that month serve written notice on the owner of his desire to proceed then he shall be entitled on paying the amount of the valuation to the owner to a conveyance of the property free from all incumbrances . . .

  "If the grantee does not serve the option notice within the time prescribed by clause 2 or if having done so he does not serve written notice within the time prescribed by and under the provisions of clause 4 of his desire to proceed with the purchase then the owner may deal with or dispose of the property free in all respects from the rights of the grantee . . ."

English and most-favored customer clauses prescribe the repercussions on the contract of matching or refusing to match the terms and conditions offered by or to a third party. In order to avoid that the existing contract be called into question too frequently, such clauses occasionally provide for constraints on their application. Such problems do not arise with first-refusal clauses, since they do not affect existing contracts but rather potential new transactions to be carried out in the future.

E. A Variation: The "Savoy Clause"

We have already noted the very great diversity of actual first-refusal clauses. The same variety is also seen in analogous contractual arrangements.

Here we will mention only the "Savoy clause," so-called because it was once used in a transaction relating to the Savoy Hotel in London. A, who wants to sell his shares in a joint business must first offer it to his partner B. B may accept or refuse, but if B refuses, B is obliged to sell his own shareholding to A.[21]

V. SPECIFIC LEGAL PROBLEMS

The clauses, which have just been considered, fall, in principle, within the ambit of freedom of contract, *a fortiori*, when they are included in international contracts. Their legal regime is first of all that which the parties have determined. It is essential therefore to devote all due care to their drafting, and in the foregoing analysis we have attempted to highlight the principal pitfalls to avoid.

Three specific legal problems, however, deserve special attention: the nature of the role of the "assessor" sometimes called upon by the parties to compare the terms and conditions on which one of them has negotiated with a third party, the penalties for failure to comply with the clauses, especially first-refusal clauses and the question whether these clauses are lawful under competition law.

A. Nature of the Role of the Independent Assessor

When we looked at English clauses and considered the problem of furnishing proof that that offer was more favorable, we suggested that one solution might be to appoint a competent independent third party to assess the competing conditions.[22] The problem re-emerged in connection with most-favored customer clauses where we quoted examples of clauses providing for recourse to an assessor in order to check the terms and conditions offered to third parties.[23] One might also contemplate appointing such an independent assessor in the case of first-refusal clauses to verify whether the other contracting party has not dealt with a third party on terms and conditions different from those that were rejected.[24]

It is worth reflecting whether such recourse to an independent assessor should be stipulated. Various questions arise. How is the assessor to be appointed? What will be the nature and the scope of his tasks? What will the consequences of his findings be? The clauses cited above[25] are dangerously silent on those different aspects.

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[21] Cf. F. De Ly, *op. cit.*, pp. 302–306.

[22] Cf. *supra*, pp. 497–498.

[23] Cf. *supra*, pp. 506–507.

[24] Cf. *supra*, pp. 518–522.

[25] Cf. *supra*, pp. 498 and 507.

As regards the assessor's task, most of the members of the group consider that it should be very limited: it is simply a matter of checking independently the terms and conditions offered by or to a third party, in order to provide trustworthy evidence. One member pointed out, however, that in some cases the assessor's task may be very complex, because of the difficulty of assessing whether the terms and conditions offered are equivalent and the need to carry out certain in-depth investigations on occasion.

This discussion raises the problem of the legal nature of the assessor's role. Is such an assessor a technical expert, a contractual regulator or an arbitrator? Arbitration, as the term is usually understood, can definitely be ruled out at this point, since it is not a question of deciding a legal dispute. The "contractual regulator" or "economic referee"[26] does not play a part in litigation, nor in determining certain facts,[27] but his role is to fill a gap in the contract, or to adapt it in the light of a change of circumstances. His decision is not an arbitration award, but forms part of the contract on equal terms with the provisions that the parties themselves stipulated.[28] Is that the role of an independent assessor? His function is the more modest one of a technical expert called upon to give the parties guidance on a question that is likely to affect their relationship. This could involve checking the output of a factory or the extent of an oil deposit; it could also be comparing two transactions. It is not a question of re-casting the contract, but of supplying factual information, which is necessary for the proper performance of the contractual obligations, in an independent way. It does not follow, at all, from that assessment that such a task may not be particularly delicate.

However, terminology is not yet firmly in place for this developing field. In the new 2003 version of its Rules for expertise, the ICC defines the "expert's" main task as to make "findings" after giving the parties the opportunity to be heard and/or to make written submissions (Article 12, 3°).[29] Earlier versions of the Rules on expertise stated that the parties could expressly confer greater powers on the technical expert, in particular the power to recommend such measures as appear to him to be the most appropriate in order to achieve the object of the contract or to supervise the performance of the contract (cf. Article 6 Section 1b of the initial rules on technical expertise issued in 1977 and Article 8 Section 1b of the revised 1993 edition);[30] the latest version does not include this addition any more.

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[26] Cf. *supra,* Chapter 9 on hardship clauses, pp. 490–491.

[27] As when assessing damages when the contract is terminated: cf. *infra,* pp. 592–593.

[28] On the relationship between contract regulation and arbitration and its recent developments, cf., however, the discussion *supra,* Chapter 9, pp. 490–491.

[29] *ICC Rules on Expertise,* 2003, available on www.iccwbo.org.

[30] Cf. L. Kopelmanas, Le Règlement d'expertise de la CCI. *D.P.C.I.*, 1977, pp. 412–422.

The ICC rules on adaptation of contracts, issued in 1978[31] but withdrawn in 1994 (due to the lack of requests for application),[32] provided for the intervention of a third party "*to fulfil the role conferred on him by the parties in the context of their contractual relationship,*" which is such a broad formula that it seemed to cover the most diverse of tasks.

As to the Guide to ICC Alternative Dispute Resolution, in its comments on Article 5,1° of the ICC ADR Rules,[33] it states that the parties may ask the "Neutral" to provide a non-binding opinion or evaluation concerning one or more matters "*such as: an issue of fact; a technical issue of any kind; an issue of law; an issue concerning the application of the law to the facts; an issue concerning the interpretation of a contractual provision; an issue concerning the modification of a contract.*"

The distinction between the role of technical expert and that of contractual regulator is not academic. As regards, *inter alia*, the implications of the third party's findings, the ICC rules on expertise provide that "*Unless otherwise agreed by all of the parties, the findings of the expert shall not be binding upon the parties*" (Article 12), whereas the now defunct rules on contract adaptation provided that depending on the parties' choice, the third party could either "*issue a recommendation*" or "*make a final decision*" (Article 11). The *Guide to I.C.C. A.D.R.* states that "*the parties are free to agree in writing that they will comply with a recommendation or decision of the Neutral, even though it is itself unenforceable*" (Introduction, Characteristics, Point 4).

It is difficult to say definitely what role is played by the assessor provided for in the clauses cited above in view of their laconic nature. It seems clear, however, in view of the foregoing considerations, that provision for recourse to an independent third party should be made expressly when the contract is drawn up, both as regards the specific rules, which will apply, and the scope of the third party's intervention. It would also be very desirable to specify, from the outset, how the assessor is to be appointed.

It must also be pointed out that inserting such a provision makes it necessary to consider the law applicable to the contract and the law applicable to the mode of dispute settlement, as well as the *ad hoc* or institutional rules that may be relevant.

A purely contractual qualification would not cause any difficulty in certain national legal systems, which admit such a mode of binding determi-

[31] *Adaptation of Contracts,* ICC Publication No. 326, 1978.

[32] Cf. Ph. Fouchard, E. Gaillard and B. Goldman, *Traité de l'arbitrage commercial international,* Paris, Litec, 1996, p. 31.

[33] *I.C.C. A.D.R. Rules*, 2001, and the *Guide to I.C.C. A.D.R.*, 2001, available on www.iccwbo.org.

nation of facts or settlement of disputes, such as Belgian law (*bindende derdenbeslissing*), Italy (*arbitraggio*) or The Netherlands (*bindend advies*). Such qualification could be accepted in most situations considered in this chapter, since the independent assessor will only verify certain facts leading to the contractual process of contract adaptation, without the third party's intervention being in itself sufficient.

On the contrary, qualifying the intervention as arbitration (e.g., if the third party's decision is final and leads by itself to an adaptation of the contract) would be more problematic, because few national legal systems (Bulgaria and The Netherlands are rare examples) allow arbitrators to fill contractual gaps or, more generally, to adapt a contract.[34]

In spite of trends in case law apparent in many countries to broaden the notion of arbitration in order to include gap-filling and contract adaptation, arbitrators, in practice, remain reluctant to adjust a contract.[35]

Finally, we would point out that such clauses providing for settlement of contractual disputes seem to be intended, above all, to play a deterrent role, with the main purpose of the option to request the services of an independent assessor being that the other contracting party will be dissuaded from acting unfairly.

B. Remedies for Infringement on the Clauses

What are the legal consequences of failing to comply with undertakings arising from the clauses that we have just analyzed?

English and most-favored customer clauses do not seem to raise serious problems in this regard. Both types of clause involve adapting an existing contract. In the event of a dispute, either the ordinary law on contractual liability or the specific provisions of the contract should normally enable the wronged party to obtain satisfaction. Difficulties could arise, however, if adapting the contract meant that it had to be re-negotiated and one of the parties failed to act in good faith in the conduct of this renegotiation. On that point, we would refer the reader, *mutatis mutandis*, to the discussions in the chapters dealing with letters of intent[36] and hardship clauses.[37]

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[34] Unless the applicable law allows a judge to do so in case of change of circumstances.

[35] On these issues, cf. P. Sanders, *Arbitration, in International Encyclopedia of Comparative Law,* Tübingen, Mohr, 1996, pp. 9–13 and 67–71; B. Oppetit, *Théorie de l'arbitrage,* Paris, PUF, 1998, pp. 72–81.

[36] Cf. *supra,* Chapter 1, pp. 44–48, as well as J.P. Desideri, *op. cit.,* p. 302, about the obligation to inform the other party of the third party's offer in implementing an English clause.

[37] Cf. *supra,* Chapter 9, pp. 476–477.

The situation is very different in the case of first-refusal clauses. Those clauses confer a preferential right for the conclusion of a new transaction. If that transaction is performed with a third party in spite of the preferential right, is there an adequate remedy to make good the opportunity which is lost forever?

The injured party will certainly be able to claim damages from the other contracting party and possibly also from the third party who acted as an "accomplice" in bringing about the breach,[38] but how is the quantum to be determined? It will doubtless be necessary to consider the loss of the benefits that would have resulted from the conclusion of the contract, but it may be hard to assess that loss. Moreover, financial compensation would often be inappropriate in such circumstances. The only true penalty would seem to be the damage to the spirit of collaboration, which had hitherto existed between the contracting parties and of which the party in breach will suffer the consequences in the future.

What is the position when the contract with the third party has not yet been concluded in disregard of the preferential right, but it is about to be concluded? At the stage where the clause has not yet been breached, is it not possible to take action in order to prevent the breach of contract and to prevent a contract from being concluded with the third party?

The urgency of such circumstances calls for a rapid procedure, such as commercial interim measures, which exist, for instance, in French law (Article 872 of the new Code of Civil Procedure) and Belgian law (Article 584 of the Judicial Code). But does the court hearing a request for interim measures have the power to prohibit the conclusion of a contract with a third party and to order the party in breach to propose the transaction to the applicant? In the absence of settled case law on first-refusal clauses, it is possible only to put forward some ideas.

Courts hearing requests for interim measures often interpret rather strictly the essentially temporary nature of their role. It is unlikely that a court would agree to intervene in the way that has just been described. Nevertheless, a change seems to be emerging in the sense that courts hearing requests for interim relief are extending the scope of ordering measures they consider within their jurisdiction, and it is conceivable that a court might provisionally forbid the conclusion of a contract with a third

[38] Cf. M. Trochu, *op. cit.*, p. 313; B. Mercadal, *Contrats et droits d'entreprises*, Paris, Francis Lefebvre, 2000, pp. 1220–1221; J.M. Mousseron, *op. cit.*, pp. 85–86. For the liability of an "accomplice" third party in French law, see, in particular, F. Terré, Ph. Simler & Y. Lequette, *Les obligations*, 7th ed., Paris, Dalloz, 1987, pp. 250–270; for the position in English law, see H. Street, *The Law of Torts*, 6th ed., London, 1976, pp. 336–347.

party on condition that the main proceedings are brought within a certain time limit.[39]

In French and Belgian law, however, the injured party would have no specific remedy in the event of failure to comply with an order of the president of the court, save that it could probably expect a better chance of being awarded damages by the court hearing the main proceedings. On the other hand, even if the party in breach did not, in fact, conclude a contract with the third party, could it be compelled to offer the contract to its partner or even to conclude a contract with that party? Whether the obligation is to enter into negotiations or to bring them to a successful conclusion, an order for specific performance seems out of the question and the other contracting party will here again only be in a position to sue for damages. The case might be different if there were already a full contractual proposition; a court might find, in such a case, that this constituted an offer that, if the other contracting party had accepted it, would thus result in its being transformed into a contract, with the judgment setting the seal on it. But how viable would a contract be if it were "concluded" under such circumstances?

It appears then that damages seem to be the only possible sanction for breach of a first-refusal clause under French and Belgian law, though we have noted the difficulties in assessing the quantum of such damages, as well as how inappropriate they are as a remedy.

Under English law, however, the courts' powers to grant injunctions could prove very useful where there is a threatened breach of a first-refusal clause.

We know that when a contractual obligation has not been performed, in principle, the common law only enables courts to award damages. Equity, on the other hand, allows the courts, in certain circumstances, to order specific performance or to grant an injunction.[40]

An injunction is an order made by a court, addressed to one or several specific parties, requiring them, to abstain, in general, from doing something (prohibitory injunction), or less often to perform a specific action (mandatory injunction). The court does not necessarily grant the injunction requested. It has very broad discretion.

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[39] On such an evolution in Belgian and French law, cf. X. Dieux, La formation, l'exécution et la dissolution des contrats devant le juge des référés, note under Trib. Liège (réf.), February 2, 1984, *Rev. Crit. Jur. B.*, 1987, pp. 250–270; J.P. Desideri, *op. cit.*, 408.

[40] See J. Beatson, *Anson's Law of Contract*, *op. cit.*, 27th ed., pp. 600–603; I.C.F. Spry, *The Principles of Equitable Remedies*, 1984, pp. 312–352; R. David & D. Pugsley, *Les contrats en droit anglais*, 2nd ed., 1985, Nos. 439–467.

It is, however, usual for an injunction to be granted where there is a threatened breach of an obligation to refrain from acting, which may correspond to the first-refusal situation. Nevertheless, the wording of the clause will be important. If party A has undertaken not to deal with X without having first offered the contract to party B, that is an express case of an obligation to refrain from acting and may lead to the issue of an injunction. English courts sometimes also recognize the existence of implicit obligations to refrain from acting, as in the case of a clause whereby A undertakes to give B a right of first refusal if A decides to carry out a particular transaction.[41] But the interpretation of the clause must be sufficiently clear. If the known circumstances do not enable its exact scope to be determined (for example, whether the clause allows or does not allow A to solicit offers from third parties in the first instance), the injunction will not be granted, since the court must be able to determine exactly which acts are proscribed. Neither do English courts appear to be prepared to grant injunctions where the first refusal relates to generic goods, or where the measure would be to the detriment of a third party acting in good faith. However, if the third party knew of the existence of the clause, which A was preparing to disregard, the court will not hesitate to grant an injunction to restrain the conclusion of a contract or even, it appears, to prevent performance of a contract which has already been concluded.

Injunctions are extremely efficient, since a party who does not comply will be guilty of contempt of court and, as such, open to heavy penalties: imprisonment, fines, sequestration of property.[42]

Another problem must also be taken into account: it is often necessary to act very quickly to prevent the contracting party seeking to act unfairly from treating with a third party. For these situations, there is in English law a procedure similar to French or Belgian commercial interim measures. It is possible to obtain an interlocutory injunction urgently if the conditions for granting an ordinary injunction appear to be met and on condition that the wronged party immediately bring proceedings on the substantive case against the party in breach. In some cases, the court may refuse to grant an interlocutory injunction if it considers that it would be apt to cause irremediable damage to the party against which it would be granted.[43]

C. Validity of the Clauses With Regard to Price Determination

Under French law, English clauses, and probably also most-favored customer clauses, may be affected by the restrictive position taken by courts as to the requirement of price determination. In a first stage, the *Cour de*

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[41] Cf. *Manchester Ship Canal Co. v. Manchester Racecourse Co.* [1901] 2 Ch. 37.

[42] Cf. I.C.F. Spry, *op. cit.*, pp. 354–356.

[43] *Id.*, pp. 430–482.

Cassation had ruled that the object of a contract had to be determinable and could not depend on the discretion of one single party.[44] With the four decisions rendered by its plenary assembly on December 1, 1995,[45] the Court now seems to distinguish between frame contracts, where one party may set the price unilaterally (without making the contract void, but under *a posteriori* court control), and individual sales contracts governed by Article 1591 of the Civil Code, which appears to prohibit unilateral price determination.[46]

Such an issue appears to be mainly a problem under French law, but certain Central and Eastern European countries, as well as some developing countries, are also hostile to contracts where the price is left to later determination by one of the parties.[47] Many other countries (e.g., the common law countries, but also Belgium, The Netherlands and Germany) have more flexible solutions as far as price determination is concerned.[48]

The following case, involving an English clause, illustrates some difficulties encountered under French law.

An exclusive supply contract provided that, each year, the buyer would notify the provisional quantity of its orders, and the seller would indicate the price of its supplies. But the buyer was allowed to inform the seller of

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[44] Cf. J. Ghestin, *Le contrat*, Paris, L.G.D.J., 2nd ed., No. 516–532.

[45] Cass., December 1, 1995, concl. M. Jéol, note L. Aynès, *Dall.*, 1996, 13.

[46] Cf. S. Valory, *La potestativité dans les relations contractuelles*, Aix-en-Provence, Presses universitaires d'Aix-Marseille, 1999, pp. 309–324; B. Mercadal, *Contrats et droits d'entreprises*, Paris, Francis Lefebvre, 2000, pp. 297–298; V. Heuzé, *La vente internationale de marchandise, Droit uniforme*, Paris, L.G.D.J., 2000, p. 152.

[47] Cf. C. Witz, Les premières applications jurisprudentielles de la Convention de Vienne sur la vente internationale de marchandises, in *The unification of international commercial law*, F. Ferrari (ed.), Baden-Baden, Nomos, 1998, pp. 165–167, who describes the famous *Malev v. Pratt and Whitney* case, where the Supreme Court of Hungary avoided a contract for lack of price determination.

[48] Cf. D. Tallon, *La détermination du prix dans les contrats (étude de droit comparé)*, Paris, Pedone, 1989, 148 pp.; I. Corbisier, La détermination du prix dans les contrats commerciaux portant vente de marchandises. Réflexions comparatives, *Rev. Int. Dr. Comp.*, 1988, pp. 767–832. Cf. also Article 55 of the Vienna Convention on the International Sale of Goods (CISG), in connection with article 14. There is a well-know controversy concerning these two provisions. (cf. V. Heuzé, *op. cit.*, pp. 145–151), with two conflicting interpretations. A first theory claims that Article 55 prevails on Article 14, with the consequence that in an international sale, Article 55 would be applicable without taking the restrictive position of French law into consideration. The flexibility of that solution is evident, but it implies judicial intervention in case of abuses. The other thesis gives priority to Article 14; with this approach, the lex contractus (in many cases, the seller's) would apply to the issue of validity of price determination by one party—not CISG. The latter opinion tends to protect the buyer against arbitrary price determination by the seller.

more favorable prices offered by competitors, in which case the seller could either align his price or waive his right to supply for the year concerned.

The Court of Appeals of Paris avoided the exclusive supply contract, because price determination was left to the seller's discretion. Could not the English clause give an objective basis for such determination? The Court is of a different opinion: implementing the clause will necessitate a new meeting of the parties' minds, e.g., to identify the competing firms whose offers could be accepted as references.[49] The *Cour de Cassation* refused to annul the decision.[50]

This decision does not condemn English clauses *per se*, but it considers that in the case under review, implementation measures did not allow for sufficient price determination. However, considering the difficulties, mentioned above, concerning the comparison of competitive offers, one can expect that it will rarely be the case.[51] Similar observations can probably be made about most-favored customer clauses.

As a conclusion, drafters of international contracts must be aware that in the present state of French law, unilateral price determination remains a delicate issue when dealing with a sales contract. More generally, it is always advisable to verify the validity of open price contracts under the applicable law.[52]

D. Validity of the Clauses With Regard to Competition Law

What is the validity of the clauses that we have just considered with regard to competition law?

On the one hand, an English clause enables the pressure of competition to affect the terms and conditions of a long-term contract and a most-favored customer clause can be a weapon against certain discriminatory practices. But, on the other hand, those clauses make it easier for lasting links to be maintained between partners. First-refusal clauses, for their part, restrict freedom to trade with third parties; their effects may be similar to those of an exclusive-dealing clause.[53]

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[49] Paris, May 2, 1986, *Jur. Cl. Pér.*, 1986, II, 20622, note J. Ghestin.

[50] Cass., June 24, 1988, *Dall.*, 1989, J, 89, note Ph. Malaurie; M. Trochu, *op. cit.*, p. 317.

[51] Cf. B. Mercadal, *Contrats et droits d'entreprises*, Paris, Francis Lefebvre, 2000, p. 299.

[52] Cf. P. Amato, U.N. Convention on contracts for the international sale of goods—the open price term and uniform application: an early interpretation by the Hungarian courts, 13 *Journ. L. and Com.* 1993, p. 22; J.M. Klotz and Barrett, *International sales agreements*, the Hague, Kluwer Law International, 1998, p. 81.

[53] Cf. the decision of Court of Justice of the European Communities rendered on November 17, 1987, in the *Philip Morris* case, 142 & 156/84, *E.C.R.* 1987, 4487.

It is notorious that, by its nature, competition law does not lend itself to hard and fast judgments. It is not possible to establish whether a clause is lawful from simply reading it, its actual economic effect must be assessed. In that respect, European law has gone through interesting developments, which we will briefly report.[54]

With regard to Article 81 of the European Union Treaty (formerly Article 85 of the Treaty of Rome), the English clause has been appraised differently depending on the circumstances.

In the case of the Dunlop/Pirelli mutual supply contract, such a clause was applied to mutual preferential undertakings concerning additional orders. The European Commission found no prohibited restraint of competition: the clause did not prevent from freely soliciting offers from competitors, and it hindered the possibility of setting excessive prices.[55]

However, in two subsequent cases, the Commission reached different conclusions. The conditions of the English clause, included in the long-term supply agreement BP-Kemi/DSF, were deemed to be too limited and too restrictive to give any useful flexibility to the exclusivity agreement.[56] In the rolled zinc products and zinc alloys case, the Commission decided that an English clause accepted by Cram to the benefit of Prayon, in an exclusive supply agreement, amounted to a restriction of competition, increasing the buyer's dependence, due to the respective sizes of the firms involved.[57]

Regulation 1984/83 of June 22, 1983, concerning the application of Article 85 Section 3 to categories of exclusive purchasing agreements, provided that brewery contracts had to allow the distributor to purchase other drinks than the beer that was the object of the agreement from third parties, when these third parties offered more favorable terms and the brewery did not match such terms (Article 8, 2° b).[58] Regulation 1984/83 was abrogated as of June 2, 2000.

The new European rules on categories of vertical agreements and concerted practices, introduced by Regulation 2790/1999 of December 22, 1992,[59] contain general provisions applicable to all types of vertical agreements (except for the sectors of automobiles, agriculture, insurance and

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[54] For more details, cf. J.M. Desideri, *op. cit.*, pp. 111–118.

[55] Decision of December 5, 1969, *O.J.E.C.*, 1969, L. 323/21.

[56] Decision of September 5, 1979, *O.J.E.C.*, 1979, L. 286/32.

[57] Decision of December 14, 1982, *O.J.E.C.*, 1982, L. 362/40.

[58] *O.J.E.C.*, June 3, 1983, L. 179/5.

[59] *O.J.E.C.*, December 29, 1999, L. 336/21.

transport). In its Guidelines on Vertical Restraints,[60] the Commission makes the following observations concerning English clauses:

> "(152) A so-called "English clause," requiring the buyer to report any better offer and allowing him only to accept such an offer when the supplier does not match it, can be expected to have the same effect as a non-compete obligation, especially when the buyer has to reveal who makes the better offer. In addition, by increasing the transparency of the market it may facilitate collusion between the suppliers. An English clause may also work as quantity-forcing . . . Quantity-forcing on the buyer will have similar but weaker foreclosure effects than a non-compete obligation. The assessment of all these different forms will depend on their effect on the market."

Most-favored customer clauses have also led to certain decisions by the Commission on the ground of Article 81.

In the Kabelmetal/Luchaire case, the former company had undertaken not to grant patent licences to other firms at more favorable conditions than those granted to Luchaire. The Commission ruled that under the circumstances, the clause did not deter the licensor from subsequently granting licences to third parties. But it stated that in particular situations, especially when the state of competition in the market at a given time was such that it was no longer possible to find other licensees without offering them much more favorable terms than those offered earlier, such an obligation could, in fact, hinder the granting of future licences and thus constitute a significant restriction to competition.[61]

In the rolled zinc products and zinc alloys case, these principles were applied to the most-favored customer clause also included in the Cram/Prayon agreement.[62]

On the other hand, Article 2 Section 1, 10° of Regulation 240/96 on the application of Article 85(3) of the Treaty to certain categories of technology transfer agreements considers as "generally not restrictive of competition . . . an obligation on the licensor to grant the licensee any more favorable terms that the licensor may grant to another undertaking after the agreement is entered into."[63]

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[60] *O.J.E.C.*, October 13, 2000, C 291/1.

[61] Decision of July 18,1975, *O.J.E.C.*, 1975, L. 222/34.

[62] Decision of December 14, 1982, cited above at note 57.

[63] *O.J.E.C.*, February 9, 1996, L. 31/2. This regulation has replaced the earlier Regulation 2349/84 of July 23, 1984 on patent licenses (*O.J.E.C.*, August 16, 1984, L. 219/15), which contained an identical provision.

A possible control of most-favored customer clauses has also been installed by Regulation 2790/1999 of December 22, 1999 on vertical agreements. According to Article 4 a), the exemption shall not apply to vertical agreements that, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object the restriction of the buyer's ability to determine its sale price.[64] At No. 47 of its Guidelines on Vertical Restraints, the Commission stated that ". . . indirect price fixing can be made more effective when combined with measures which may reduce the buyer's incentive to lower the resale price, such as . . . the supplier obliging the buyer to apply a most-favored-customer clause."[65]

On the other hand, Article 82 of the European Union Treaty (formerly Article 86 of the Rome Treaty) also served as a basis for decisions concerning English clauses. This clause was retained by both the Commission and the Court of Justice among the elements making the conduct of Hofman-Laroche an abuse of economic power.[66] The Court agreed that the clause allows remedying some unfair consequences of exclusive supply undertakings. But it may also increase the abusive character of a dominant position by its restrictive implementation measures and the information undertakings it implies. The Guidelines on Vertical Restraints confirms this when indicating that Article 82 "specifically prevents dominant companies from applying English clauses or fidelity rebate schemes" (No. 152 *in fine*).[67]

Care will thus be taken, depending on the circumstances, to verify the compatibility of the clauses under discussion with competition law.

VI. FINAL CONSIDERATIONS

Although each of the three clauses examined has its own particular features, they also have many in common. The similarities, which were mentioned at the beginning of this review, have emerged clearly throughout the subsequent analysis. We would particularly like to emphasize that the three clauses are characteristic of the existence of long-standing economic relations between parties.

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[64] This does not exclude the possibility for the supplier to set a maximum or to recommend a sale price, provided that this does not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties (Art. 4a) in fine).

[65] *O.J.E.C.*, October 13, 2000, C 291.

[66] Decision of the Commission, June 9, 1976, *O.J.E.C.*, 1976, L. 223/27; Court of Justice, February 13, 1979, *E.C.R.*, 1979, 461.

[67] *O.J.E.C.*, October 13, 2000, C 291. In France, the *Conseil de la concurrence* decided in 2003 that most-favored insurer clauses stipulated when setting up a co-insurance scheme can have an anti-competitive effect (*L'Argus de l'assurance*, May 14, 2004, p. 45).

English clauses, most-favored customer clauses and first-refusal clauses are not without their dangers. There are many pitfalls to avoid in their implementation. The risk of offers of convenience may distort the operation of English and first-refusal clauses. The difficulties in effecting checks may make most-favored customer clauses and first-refusal clauses nugatory. The fact that sanctions are rather inadequate, means that first-refusal clauses have to depend on the probity of the other contracting party. Negotiations with a third party may be made very difficult if the third party learns that, before a contract is concluded, the other contracting party will offer preferentially the terms and conditions on which agreement has been reached to another party with whom it has signed an English clause or a first-refusal clause. In every instance, the problems of comparability and proof give cause for concern. In some jurisdictions, price determination may be a problem. In each case, a check must be made to be sure that clauses are lawful under the rules of competition law.

On the economic level, moreover, it appears that English clauses and most-favored customer clauses are, for the most part, stipulated, almost as standard clauses, in periods of relative price stability.[68] When prices are falling, the operation of such clauses is apt to hit hard those parties who are compelled to reduce their prices, in particular where such clauses have been systematically incorporated into connected contracts (for example, licensing contracts).

Thus, a warning for negotiators emerges from this analysis. There is an interest in concluding first-refusal clauses, English clauses and most-favored customer clauses, but they should be worded with the greatest caution in view of the drafting difficulties described in this review and of the risks which have just been called to mind.

[68] These clauses are rarely encountered in sectors of the economy where market conditions are always in fluctuation, for example in the shipping industry.

By contrast, hardship clauses are a characteristic feature of contracts concluded in periods of economic instability.

CHAPTER 11
ASSIGNMENT CLAUSES

I. WORKING METHOD

True to its objectives, the Working Group looked at assignment and transfer and synonymous clauses in international commercial contracts from the perspective of international contract draftsmen. On the basis of discussions and analyses of sample clauses provided by its members working in the legal or contract departments of companies or working in private practice,[1] general trends and problems regarding these clauses were observed. This chapter attempts to provide a summary of the discussions and analyses. The various elements of these clauses are emphasized and are given extensive attention. The disadvantage is that these elements are much isolated from one another and that their intrinsic links are insufficiently stressed. To fully understand assignment clauses, one should take an overall perspective of assignment clauses including their various elements, other contract clauses[2] and the factual background of the circumstances in which these clauses have been or should be used.

Also, attempts to classify assignment clauses (see Sections IV.F through IV.I) may create the false impression that all assignments clauses fall within one of these categories. However, classification only seeks to better understand the various options available to contracting parties; it does not intend to be comprehensive.

Finally, one should note that assignment clauses in international commercial contracts tend to be standardized, to a certain extent, since their contents and wordings are often very similar from one contract to another. To some degree, one might characterize assignment clauses as boilerplate

[1] Also, the following assignment clauses contained in international instruments may be mentioned: Article 27 of the ICC Model Commercial Agency Contract, ICC Publication No. 644, Paris, ICC Publishing, 2002; Article 26(4) of the ICC Model Distributorship Contract, ICC Publication No. 646, Paris, ICC Publishing, 2002; Chapter XXVII (Transfer of contractual rights and obligations) of the Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works, UNCITRAL, U.N. Sales No. E.87.V.10, Doc. A/CN.9/SER.B/2, 1987.

[2] See, for instance, the relationship between assignment clauses and termination clauses mentioned by J.M. Mousseron (*Technique contractuelle*, Paris, Lefebvre, 2nd ed., 1999, pp. 229–230). In those cases, the transfer of the contract by the assignor entitles the obligor to terminate the contract in order to avoid contractual relationships with the assignee.

clauses that are copied from one contract to another not only within the same company or law firm but also across the legal profession.

II. INTRODUCTION AND DEFINITIONS

Assignment of rights (often but not always of accounts receivable) and transfer of contracts are important in business life. Since business relationships are increasingly concluded on a more impersonal basis (*intuitu pecuniae*), transfers of rights and of contracts occur frequently and for various reasons (e.g., collection of money claims, sales of receivables and, in relation to financing, as an instrument of vesting security interests). Corporate re-structuring often involves issues as to the transfer of contracts and assignment of rights (e.g., mergers and acquisitions, demergers, asset sales). Thus, the primary focus of the analysis is the question of how international contract drafting dealt with the various elements of these problems.[3]

Before discussing the scope of this chapter, some terminological indications should be given. Regarding both assignment of rights and transfer of contracts, *assignor* and *assignee* will be used as legal terms of art to indicate the party who assigns the rights or transfers the contract and the party to whom such a transfer is made. This terminology conforms to the expressions generally used in assignment clauses. Designating the party whose obligations are being transferred, in the case of an assignment of rights, or whose rights and obligations are transferred, in the case of a transfer of contract, is more complicated. Assignment clauses generally have no standard vocabulary to indicate that party. In the field of assignment of rights, the term *debtor* (in French *le cédé—debitor cessus*) is used. This term is used throughout this chapter in order to express the assignor's counter-party under the original contract in a situation of assignment of rights. In the case of transfer of contract, the term *obligor* will be used.

Assignment of rights and transfer of contracts are both well known in international business life. As to the law on assignments, many civil law countries have statutory rules on assignment of rights. These rules generally deal with the relationships between assignor, assignee and debtor as to the assignment of rights. Those rules determine the assignability of rights, the rights and obligations between assignor and assignee, the warranties of the assignor *vis-à-vis* the assignee, the rights of the assignee *vis-à-vis* the debtor and the formal requirements for the assignment to become effective *vis-à-vis* the debtor and other third parties, the obligations and protec-

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[3] See on this subject: J.M. Mousseron, *op. cit.*, pp. 215–235; A.G.J. Berg, *Drafting Commercial Agreements*, London, Butterworths, 1991, pp. 174–176; R. Christou, *Boilerplate Practical Clauses*, London, Financial Times Law & Tax, 2nd ed., 1995, pp. 189–190; L. Aynes, *Les clauses de circulation du contrat, in Les principales clauses des contrats conclus entre professionnels*, Aix-en-Provence, Presses Universitaires d'Aix-Marseille, 1990, pp. 131–139.

tion of the debtor (*debitor cessus*) *vis-à-vis* the assignee. Transfer of contracts is generally not covered by legislation in civil law jurisdictions[4] and has been developed, in practice, where various methods are used. In this respect, the crucial point is that the transfer of the contract does require the consent of the obligor because debts are generally not transferable. Giving the original creditor a new debtor as a result of the transfer of the contract (substitution of debtors) thus requires the consent of the obligor. Many assignment clauses will provide for rules and procedures in order to obtain the original creditor's consent.[5] In common law jurisdictions, transfer of contracts raises the same problem as in civil law countries. Only the benefits of the contract are in principle assignable, whereas the burden may only be transferred with the consent of the creditor. The latter situation will then result in a novation (i.e., a new contract between the assignee and the creditor).[6]

III. SCOPE OF THE CHAPTER

Because of the vast range of issues regarding assignment of rights and the transfer of contracts, some restrictions had to be made to limit the scope of this chapter. First, the analysis dealt only with general problems of the law of obligations regarding assignments. Special contracts or rights that, under the applicable law, may be affected by special considerations or are governed by specific provisions (e.g., employment contracts,[7] insurance contracts, intellectual and industrial property rights, arbitration agreements,[8] negotiable instruments[9] and securities[10]) were not included in the

[4] Exceptions are Italy (Articles 1406–1410 CC), Portugal (Articles 424–427 CC) and The Netherlands (NBW, Article 6:159).

[5] Differences in terminology between various jurisdictions regarding assignment of rights and transfer of contracts is a factor that to a large extent complicates activities in these fields.

[6] See on English law regarding this topic, *Linden Gardens Trust Ltd v. Lenesta Sludge Disposals Ltd and others* [1993] 3 All E.R. 417 (House of Lords).

[7] In the European Union, one may refer to Directive 77/187 of February 14, 1977 (OJ L. 61, March 5, 1977, 26–28) on the approximation of the laws of the member States relating to the safeguarding of employees' rights in the event of transfers of firms, businesses or parts of businesses as well as to the extensive case law of the European Court of Justice regarding the interpretation of this Directive and the recent Council Directive 2001/23/EC of March 12, 2001 on the approximation of the laws of the member States relating to the safeguarding of employees' rights in the event of transfers of firms, businesses or parts of firms or businesses (OJ L. 82, March 22, 2001, p. 16).

[8] E.g., under French law, Ph. Delebecque, La transmission de la clause compromissoire, *Rev. Arb.*, 1991, pp. 19–32.

[9] E.g., forfaiting.

[10] In this latter respect, one may refer to the trends in modern financial techniques to express debts in securities (securitization—*titrisation*).

analysis. Legal techniques such as subrogation, delegation and novation or legal problems having features akin to assignment (e.g., sub-contracts in multi-party contractual settings) were equally excluded from extensive and express review, albeit that their relation with assignment clauses will briefly be discussed (see Section IV.E). Furthermore, competition law (including merger law) aspects of assignment clauses are not covered in this chapter, notwithstanding their importance and the frequency of competition-law-sensitive provisions in assignment clauses. Finally, the analysis was restricted to clauses in international contracts regulating assignments thus excluding the *contract of assignment* itself between assignor and assignee. Thus, only clauses about assignment and not assignment contracts[11] were looked into. It was generally felt that the project could be achieved without the need for national reports or reports on international instruments regarding assignments. This is primarily due to the fact that contract clauses regarding assignment, by their very nature, make attempts to regulate the relationships between the contracting parties and generally, under applicable laws, may not effectively regulate the position of third parties. Assignor and debtor/obligor may thus regulate their respective rights and obligations well in advance by contract in case of subsequent assignment (but they can do no more than set certain parameters affecting interests of third parties such as the assignee's). The latter will then be determined by the rules applicable to the relationships *vis-à-vis* the third party.[12] Consequently, the

[11] Generally, the relationship between assignor and assignee has been excluded from the analysis. This relationship may stem from a specific assignment contract but may also originate from a framework contract as is the case in bulk transfers (e.g., factoring).

[12] In the European Union, the conflict of laws problem will be governed by the Rome 1980 Convention on the Law Applicable to Contractual Obligations (OJ L. 266, October 9, 1980, pp. 1–19) and, in particular regarding assignments of receivables, by Article 12 of that Convention.

As to substantive rules applicable to assignments, one should distinguish between international instruments uniforming the law on assignment and national law. In respect of the former, mention should be made of the 1988 Unidroit Convention signed in Ottawa on May 29, 1988 regarding international factoring. This Convention entered into force on May 1, 1995 in France, Italy and Nigeria (Unidroit News Bulletin, No. 99/100, July/October 1994, p. 7) and may also be relevant for debtors in third countries in view of the Convention's provisions on the scope of application. Also, one may note the 2001 Uncitral Convention on the Assignment of Receivables in International Trade which has not yet come into force.

The 2004 Unidroit Principles on International Commercial Contracts (Chapter 9) and the Principles of European Contract Law (Chapters 11 and 12) also contain rules on assignment of rights and transfer of contracts.

Regarding national law on assignments, one may note the following literature: *La transmission des obligations*, IX Journées d'études juridiques Jean Dabin, Bruylant, Brussels, 1980, 748 pp.; Ph. Reymond, *La cession des contrats*, Lausanne, Cedidac, 1989, 125 pp.; H. Kötz, Rights of Third Parties, Third Party Beneficiaries and Assignment,

following issues regarding assignment law are not dealt with in assignment clauses in international contracts:

1. the assignability of the rights under the applicable law;
2. the rights and obligations between assignor and assignee;
3. the warranties of the assignor *vis-à-vis* the assignee;
4. the rights of the assignee *vis-à-vis* the debtor/obligor;
5. the obligations and protection of the debtor/obligor *vis-à-vis* the assignee;
6. the priorities of the assignee over prior or subsequent assignees and the creditors of the assignor; and
7. the conflict rules regarding the relationship between the assignor and the assignee and that between the assignee and the debtor/obligor.

IV. ANALYSIS OF ASSIGNMENT CLAUSES IN INTERNATIONAL CONTRACTS

A. General Observations

Assignment clauses are primarily concerned with the intervention of third parties in the contractual relationships between the original contracting parties. May a third party assume part or all of the rights of one of the contracting parties (assignment of rights), or may a third party not only become creditor but also debtor under the original contract (transfer of the contract)? In this respect, traditional concepts of contract law instruct us that some contracts are concluded *intuitu personae* (as opposed to contracts *intuitu pecuniae*) and thus, parties may, in effect, impose this characteristic by introducing restrictions as to the assignability of the contract.[13] This rule raises the question as to the definition of contracts concluded *intuitu personae.*[14] Generally, one might say that these contracts are concluded on the basis that the identity of at least one of the contracting parties is essential to the formation and performance of the contract. The

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International Encyclopedia of Comparative Law, Vol. VII, Chapter 13, Tübingen, Mohr, 1992, 102 pp. See also R. Goode, Assignment Clauses in International Contracts, *I.B.L.J.* 2002, pp. 389–406.

[13] This traditional concept is sometimes challenged on the basis that contracts are in principle transferable and that, therefore, *intuitus personae* is to be understood restrictively. Consequently, restrictive assignment clauses should also be interpreted restrictively and many assignment clauses are to be interpreted in the sense that they do not prohibit the transfer of the contract but rather impose the conditions for making the assignment effective. In that view, judges or arbitrators ultimately would determine the conditions for the transfer (see L. Aynes, *loc. cit.*, pp. 134–136). This opinion may be questioned in so far as it relates to economic transactions where party autonomy prevails. *A fortiori*, one might doubt whether it may be applied to international commercial transactions.

[14] See Ph. Marchandise, Le changement de cocontractant dans les contrats à prestations successives, in *La vie du contrat à prestations successives*, Brussels, 1991, pp. 149–157.

identity of the contracting party may relate to subjective factors (e.g., confidence) but also to objective parameters such as technical, commercial or financial qualities.

In this respect, assignment clauses are examples of the *intuitu personae* character of the contract. They avoid the uncertainties related to a judicial determination of the character of the contract. In this respect, assignment clauses very often tend to protect and guarantee the original position between the contracting parties by not allowing any changes at all in the parties brought together by the contract (see Section IV.H.2. no-assignment clauses) or by restricting assignment (see Section IV.H.3 restrictive assignment clauses). Therefore, contracts with assignment clauses are generally to be interpreted as contracts concluded *intuitu personae.* The opposite statement (i.e., contracts without assignment clauses are not concluded *intuitu personae*) is not correct because a judge or arbitrator may well find that a contract, which does not contain an assignment clause, has been formed *intuitu personae* and is therefore not as such assignable. Assignment clauses, thus, are indications of the *intuitu personae* character of the contract and furthermore do provide for a contractual regulation of the effects of such a characterization in the transfer of the contract. The assignment clause has a double function: (1) it characterizes the contract as *intuitu personae*;[15] and (2) it regulates assignment as to its requirements, procedures and effects. This chapter will primarily discuss the second function. As to the first function, assignment clauses may thus well affect other contractual clauses and, more generally, the contractual relationship between the parties (for instance, interpretation or performance of contractual obligations by subcontracting or by delegation).

Assignment clauses sometimes refer to this basic underlying philosophy. Three clauses follow:

- "This Agreement shall be personal to the parties to it save that . . . the benefit of any of its provisions may be assigned to any company which is a subsidiary of the party concerned or which is a holding company of such party or a subsidiary of such holding company . . ."
- "This Agreement is personal in nature and the parties' rights hereunder cannot be assigned, nor can the performance of their duties be delegated without the prior, written consent of the other party, such consent not to be unreasonably withheld."

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[15] Contractual characterizations will only have a limited effect if public policy or mandatory rules are concerned. In other situations, differences of opinions exist as to the question whether a characterization by the parties in a contract is binding upon judges or arbitrators. In France, this debate is influenced by Article 12, paragraphs 1 and 2 of the *Nouveau Code de Procédure Civile* (NCPC). For more details, see Chapter 3, p. 126.

- "This Agreement is a personal one, being entered into in reliance upon and in consideration of the singular personal skill and qualifications of the Consultant. The Consultant shall therefore not voluntarily or by operation of law assign or otherwise transfer the obligations incurred on its part pursuant to the terms of this Agreement without the prior written consent of the Company."

In the first case, the clause does not expressly mention that assignment other than to affiliates is prohibited, while the two latter clauses provide the background of the clause and determine as well the legal consequences as to assignability.

These clauses raise the question whether the assignment clause should not only outline the conditions, procedures and effects of assignment but also whether the rationale for restricting assignability should be expressed. Most clauses do not expressly state the fact and the reasons for the *intuitu personae* character of the contract. The aforementioned clauses are, in this regard, quite exceptional. A more general expression of the *intuitu personae* character of the contract in the assignment clause is certainly advisable if that character is strong, and one would want to emphasize that character that may reinforce the above-mentioned first function of assignment clauses and have effects in other cases than assignment situations. On the other hand, if one were to prefer limiting the scope of the assignment clause to assignment-only situations, one may consider not expressing the *intuitu personae* character in the assignment clause.

Assignment clauses generally deal with a number of issues. However, some problems have hardly been regulated at all in the assignment clauses that have been analyzed. These problems relate to:

1. the purposes of assignment;
2. the distinction between assignments of existing rights and assignments of future rights;
3. the distinction between individual assignments and bulk assignments;
4. the form of assignment;
5. waiver of defenses by the debtor/obligor;
6. subsequent assignments; and
7. conflict rules between assignor and debtor/obligor.

As to the purposes of assignment, one clause provided for compulsory assignment on the part of a contractor of his contracts with suppliers and sub-contractors in case of termination or discontinuation of the contract to enable the other party to finish the works:

> "Contractor shall arrange that any rights and titles (together with the obligations connected therewith) relating to Work which

Contractor may directly or indirectly acquire vis-à-vis third parties can, if so required by Company, be assigned to Company in the event of discontinuation due to Contractor or termination of the Contract as referred to in articles 16 and 17 respectively."

In another case, the assignment clause purported to enable the buyer of an aircraft to assign the contract to a financial institution engaged in the financing of the purchase. One may assume that the assignment of the contract to the financial institution was intended to convey a security interest to that institution. Finally, another clause stated that assignment of a party's interests in a contract was permissible by way of pledge, in its ordinary course of business, to a bank or a financial institution.

Assignment clauses in international contracts are—to the extent that Article 12(2)[16] of the Rome Convention on the Law Applicable to Contractual Obligations[17] is applicable—to be governed by the law applicable to the contract as to the relationship between the assignor and the debtor. Many international commercial contracts contain a choice-of-law clause, and the law thus designated will apply. In this respect, one may note that the assignment clauses studied did not themselves refer expressly or implicitly to the law thus chosen,[18] leaving the issue to the boilerplate clause on applicable law.

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[16] This provision reads as follows: "The law governing the right to which the assignment relates shall determine its assignability, the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and any question whether the debtor's obligations have been discharged."

[17] This Convention is applicable in 12 of the 15 European Union member States. Conventions providing for the accession of Austria, Finland and Sweden and of the ten new member States to the Rome Convention have not yet entered into force. One may note that Austria and Finland have already legislation that conforms to a large extent with the provisions of the Rome Convention.

[18] The applicable law may, for instance, be relevant in relation to the effectiveness of clauses prohibiting assignment (*no-assignment clauses*) or requiring the debtor's consent to assignment (*restrictive assignment clauses*). This may be relevant since countries have various attitudes towards the possibility for contracting parties to prohibit or restrict assignment of rights. In some countries, party autonomy governs and assignments made in violation of no-assignment or restrictive assignment clauses may be held unenforceable (e.g., Germany: Section 399 BGB—*pactum de non cedendo* but not in commercial transactions Section 354a HGB); Austria: OGH, Juristische Blätter, 1984, 311; England: *Linden Gardens Trust Ltd v. Lenesta Sludge Disposals Ltd and others* [1993] 3 All E.R. 417 [House of Lords]). In other countries, interest in receivables financing prevails which leads to legal rules rendering no-assignment or restrictive assignment clauses ineffective. For instance, one may note that in the United States no-assignment clauses in contracts are ineffective under UCC Section 9–318(4). This position has been followed by Article 6 of the 1988 Factoring Convention. This Convention has entered into effect and is applicable in France, Italy, Nigeria, Hungary, Latvia and Germany. However, since the negotiations within Unidroit regarding the invalidity of no-assignment clauses gave rise

B. Headings

Various headings are used for assignment clauses. In the clauses that were analyzed, the following headings were found:

> Assignment, Assignments, Successors and Assigns, Assignability, cession du contrat, Successors, Novation and Assignment, Assignment and Sub-Contracting

C. Distinction Between Transfer of Contract and Assignment of Rights

Many clauses do not expressly distinguish between assignment of rights and transfer of contracts and treat both alike. For instance:

- "Neither Company nor Contractor shall be entitled to assign in whole or in part any of its rights and obligations . . ."

- "Les droits et obligations résultant du présent contrat sont incessibles à des tiers sans l'accord exprès de chacune des deux parties contractantes."

In some contracts governed by English law, assignment clauses dealt only with the assignment of rights under the contract and not with the transfer of the contract:

> "Subject to Clauses 6.7.2.2 and 6.7.2.3, this Deed is personal to the parties to it. Accordingly, no Buyer may, without the prior written consent of the other, assign the benefit of all or any other party's obligations under this Deed, nor any benefit arising under or out of this Deed."

In some instances, the assignment clause expressly refers to the transfer of the contract:

- "This Contract is not assignable by either party without the prior written consent of the other party, . . ."
- "Otherwise, Contract shall not be assigned in whole or in part by either party without the consent of the other."

However, these clauses remain obscure as to the question whether they also cover assignment of rights. Thus, contract draftsmen may be advised clearly to indicate whether or not the assignment clause covers both the assignment of rights and the transfer of the contract.

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to controversy, the Factoring Convention contains a compromise since contracting States may make a reservation against article 6. France and Latvia have used this reservation in order not to be bound by the ineffectiveness of no-assignment clauses.

In one sample clause, a distinction was made between the assignment of money rights and the assignment of other rights:

> "Neither this Agreement nor any right (other than the right to receive the payment of money) or obligation hereunder may be assigned in whole or in part by any party without the prior written consent of the other parties."

Finally, assignment clauses sometimes but not frequently identify rights that are subject to special assignment requirements. For instance:

> ". . . Buyer's right to deliveries hereunder shall not, without Seller's written consent, be transferable to any assignee or successor of Buyer . . ."

The above-cited examples may create the impression that contract draftsmen, in most cases, consider carefully whether and to what extent assignments should relate to rights only or to the transfer of the contract as a whole. However, many assignment clauses tend to create the opposite impression, i.e., that contract draftsmen did not pay much attention to this issue and try to cover many assignment situations in broad terms. Because of the different legal rules applicable to assignment of rights and transfer of contracts, one should state clearly whether the assignment clause is applicable to both situations. One might perhaps also differentiate between these two cases.

D. The Location of Assignment Clauses in the Contract

Assignment clauses do not have a fixed place in the contract but are generally to be found more towards the end of the contract among the boilerplate provisions and after the more commercial contractual provisions. Often, assignment clauses are clearly identifiable contract clauses that deal only with assignment. Sometimes, assignment clauses are also found in a contract article headed *Miscellaneous, Miscellaneous Provisions* or something similar.

E. Relationship of the Assignment Clause to Related Mechanisms

Assignment clauses can often be found in international commercial contracts that deal only with assignment. Less frequent are assignment clauses that not only deal with assignment but also with sub-contracting, substitution, novation[19] or delegation. The following examples illustrate:

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[19] Assignment and novation clauses exist frequently in the context of pre-incorporation obligations of companies that are in the process of being incorporated. The novation and assignment clause is then intended—to the extent that is required by the law applicable—to have an incorporating company transfer the obligations to the newly formed company.

- "Neither this Agreement nor any right or obligation hereunder may be assigned or delegated in whole or in part by any party without the prior written consent of the other parties."
- "X se réserve le droit, ce qui est accepté par Y, de se substituer toute société du groupe X dans l'exécution du présent contrat. Y se réserve le droit, ce qui est accepté par X, de se substituer toute société de son propre groupe."

It should not surprise us that these various techniques may be regulated in the same contract clause, since they all give effect to the personal relationship between the contracting parties (*intuitu personae*) that arise because the contracting parties have contracted with one another on the basis of their respective qualities. Consequently, they may want to control any eventual assignment, sub-contracting, substitution, novation or delegation of the contract and do so in one contract clause in order to treat these issues alike. However, the same rationale for these clauses does not necessarily imply that all these mechanisms should be given equal treatment. One might well want to differentiate between these various techniques.

F. Unilateral and Bilateral Assignment Clauses

In many cases, assignment clauses are bilateral. This means that the assignment clause may be applied to both contracting parties whenever they would like to transfer the contract or assign its rights. For example,

> "Each of the Parties may at any time assign all or part of its said interest . . . if and only if . . . the remaining, non-assigning Parties shall have consented to such assignment in writing (which consent may only be withheld on the grounds of . . ."

Bilateral assignment clauses may be symmetrical or asymmetrical. The example cited above is symmetrical since the assignment clause treats both parties alike. In asymmetrical clauses, a distinction is made between the position of the parties. The different treatment of the parties is often to be explained by their respective bargaining power. An example of an asymmetrical clause:

> "This License Agreement is not assignable by Licensee without the prior written consent of Licensor. It shall be assignable by Licensor without Licensee's prior consent provided the assignee receives all rights and properties possessed at the date hereof by Licensor which are pertinent to this License Agreement, and agrees to be bound in all respects in place of Licensor."

However, unilateral assignment clauses also exist where the assignment clause only envisages the position of one of the contracting parties. This

may be related to the specific nature of the contract, as for instance in the following case relating to an aircraft financing where the assignment clause only refers to the buyer's option to assign the contract or his rights under the sale contract:

> ". . . this Agreement shall be assignable by Buyer in whole or in part to a wholly-owned subsidiary or affiliate of Buyer or any financial institution which is providing financing to Buyer in connection with Buyer's acquisition of the Aircraft . . ."

Unilateral assignment clauses may also give an indication as to the parties' bargaining position in negotiating the contract (for an example, see Section H.1).

G. Compulsory and Voluntary Assignment

In some legal systems, assignments do not only take place by agreement between the assignor and the assignee (voluntary assignments) but by law that imposes assignment[20] or provides for the possibility that a judge may order assignment.[21] Generally, assignment clauses do not distinguish between voluntary and compulsory assignments, which raises the question whether both situations must be deemed encompassed in the clause. To the extent that mandatory rules are involved, the issue is much less relevant because contractual restrictions on assignment, which run counter to mandatory rules, will generally be ineffective. In any event, the safest course is to draft the assignment clause in a broad way drawing the distinction between voluntary and compulsory assignments. In a limited number of clauses, such a distinction has been made:

- "Any provision herein to the contrary notwithstanding, this Agreement shall inure to the benefit of, and be binding upon the parties hereto and their respective successors and assigns, but it shall not be voluntarily assigned in whole or in part by either party without the prior written consent of the other party provided . . ."
- "This Agreement is a personal one, being entered upon and in consideration of the singular personal skill and qualification of the Consultant. The Consultant shall therefore not voluntarily or by operation of law assign or otherwise transfer the obligations

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[20] E.g., transfer of employment contracts in the European Union by virtue of Directive 77/187 of February 14, 1977 (OJ L. 61, March 5, 1977, 26–28, now Directive 2001/23/EC of March 12, 2001) on the approximation of the laws of the member States relating to the safeguarding of employees' rights in the event of transfers of firms, businesses or parts of businesses.

[21] E.g., under French law, a judge may order the transfer of contracts in the case of insolvency proceedings.

incurred on its part pursuant to the terms of this Agreement without the prior written consent of the Company."

- "This Agreement and the rights, benefits, obligations and remedies hereunder or any interest therein shall not be assignable or transferable by operation of law or otherwise by any party without the prior written consent of the other parties."

H. Various Clauses Regulating Assignments

This section of the chapter will discuss the various clauses in which the contracting parties have regulated assignments. In this respect, some clauses give one party a right to assign (Section IV.H.1), other clauses contain an absolute ban on assignment (Section IV.H.2). Most clauses restrict assignments but make them not impossible (Section IV.H.3). Finally, clauses often provide for exceptions to these restrictions (Section IV.H.4).

1. Right to Assign[22]

Contracting parties, with strong bargaining power, sometimes succeed in imposing upon the other contracting party an assignment clause that gives them an unconditional right to transfer the contract or assign its rights, for instance to affiliated or other identified companies. For example:

> "Owner at his sole discretion and by simple notice of assignment to Contractor shall have the right to freely assign, charge, transfer or declare any trust over the Contract or any part thereof or any right, benefit or interest arising thereunder to any shareholders of the Owner or any of its affiliates."

2. No-Assignment Clauses

Sometimes, assignment clauses contain an outright and absolute prohibition to transfer the contract or assign its rights. For instance:

> "Contractor shall not assign the Contract, nor transfer any part of it, nor any benefit, interest, right or obligation therein nor payment due thereunder."

The absolute prohibition to assign may be general or might be limited to certain territories or to certain persons.[23] Absolute bans on assignment or transfer may be troublesome in practice if one party insists on assignment or transfer while the other party invokes the absolute ban. The solution will then have to be found in the termination of the contract according to its provisions and the conclusion of a new contract with the potential

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[22] See also J.M. Mousseron, *op. cit.*, p. 230 (*les clauses de tolerance*).

[23] J.M. Mousseron, *op. cit.*, pp. 226–227.

assignee. Since this may be an unattractive option, the absolute ban might be challenged and tested in court. No-assignment clauses are thus inflexible and may give rise to litigation. Less absolute restrictions are probably preferable.

3. Restrictive Assignment Clauses

In many cases, assignment clauses do not prohibit assignment absolutely but specific conditions under which assignment is possible. These clauses restrict rather than prohibit assignment and may be called *restrictive assignment clauses.* They have the advantage of being much more flexible than no-assignment clauses. The restrictions relate primarily to the consent to be sought by the assignor from the debtor/obligor and operate as a conditional anticipatory consent to assignment. For instance:

> "Each of the Parties may at any time assign all or part of its said interest . . . if and only if . . . the remaining, non-assigning Parties shall have consented to such assignment in writing (which consent may only be withheld on the grounds of lack of financial responsibility and capability of the proposed assignee to discharge the obligations under this Agreement as they relate to the interests to be assigned)."

As one may see from the just cited example, the conditions imposed may deal with various issues regarding the assignment. The following issues have been identified:

1. the time at which assignment is possible;[24]
2. the procedures to be followed in order to obtain consent;
3. the formal requirements for giving such consent;
4. the criteria for refusal to consent to assignment;
5. the consequences of not giving consent within a certain period;
6. the remedies for the party seeking consent to challenge a refusal to consent to the assignment; and
7. the sanctions in case of non-compliance with the restrictions contained in the assignment clause.

Some of these elements will be discussed hereafter.[25]

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[24] Most clauses do not deal with this issue. In one case, the stipulation was that assignment was possible at any time: "Each of the Parties may at any time assign if the remaining, non-assigning Parties shall have consented . . ."

[25] Not all issues can be discussed within the context of this report. For instance, one clause provided that consent to assignment granted by either party shall not be deemed a waiver in any subsequent case triggering the assignment prohibition of an assignment clause. Regarding non-waiver clauses, see Chapter 3, p. 163ff.

a. Procedure to Obtain Consent

Also, assignment clauses hardly deal with the procedures to be followed for getting the debtor's/obligor's consent.[26] In one rare exception, see the following clause:

> "Where either Partner (in this clause called 'A') wishes to assign its rights it shall notify the other (in this clause called 'B') and as soon as practicable furnish to B such information about the proposed assignee as may be available and reasonably requested by B.
>
> B shall decide whether or not to consent to such assignment or terminate the partnership as terminating partner under Clause 12 below. B shall notify such decision to A in writing as soon as practicable and in any event not later than twenty days after notice shall have been given under Clause 11.1)."

b. Formal Requirements

Often but not always, restrictive assignment clauses provide for the formal requirements of any consent to be given and mostly make the compliance with such requirements a condition precedent of the assignment of the contract:

> "No such assignment shall be effective or binding upon the Parties until the date upon which the assignor or assignee furnishes all the Parties with . . . a written instrument in form and content satisfactory to the Parties and duly executed by the assignee . . ."

c. Criteria for Refusing Consent

Various criteria are used on which a refusal to consent to the assignment may be based. The various criteria may be determined by different factors including the bargaining power of the contracting parties.

At one extreme, one finds clauses that require consent without specifying the standards according to which consent or refusal is to be given:

> ". . . without the prior written consent thereto of the other party."

It is unclear whether these clauses express a discretionary power on the part of the debtor/obligor to give or refuse his consent, or whether these clauses are to be interpreted that the parties did not settle the issue and

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[26] There are, however, some exceptions to this rule. In some contracts such as share transfer agreements and joint-venture contracts, these procedures generally do receive sufficient attention.

that, therefore, there is further scope for common principles of contract law to determine whether consent is to be given or ought to have been given. In order to avoid these complications, contracting parties sometimes clearly express the discretionary nature of the consent of the debtor/obligor as in this case:

- "B shall having regard to the financial standing and business experience of the assignee and the likely effect on the partnership and its business of the assignment, in its absolute discretion decide whether or not to consent to such assignment . . ."
- "Supplier may not assign or transfer any of its rights, benefits or obligations under this Agreement without the prior consent of X given in writing in each case (which consent X may refuse at its discretion)."

While the second example is clearly discretionary, the first one is not. In that case, both a discretionary criterion and some objective parameters are used that may be contradictory and give rise to interpretation problems and litigation.

In other cases, the parties expressly refuse to give discretion to one of them in deciding whether or not to consent to assignment. Then, the contracting parties in their assignment clause expressly attempt to stipulate more objective standards regarding one party's consent to assignment. In relation to these clauses, one basically finds two categories. On the one hand, some clauses provide for an open-ended formula stating that consent should not unreasonably be withheld:

- "Neither this Agreement nor any of the rights of the Buyer hereunder shall be assignable by Buyer in whole or in part without Seller's written consent which shall not be unreasonably withheld."
- "La banque se réserve le droit de transférer, en tout ou en partie, à d'autres banques tous les droits et obligations résultant de la présente convention. Un tel transfert ne pourra avoir lieu qu'avec l'accord écrit de la créditée, qui ne sera pas refusé sans raison."

These clauses tend to express the idea that assignment may only be refused for cause, which may imply that refusal should also be motivated and is subject to review by courts or arbitrators on the basis of notions of reasonableness or good faith. This approach offers flexibility but, on the other hand, increases risks of disputes over the question whether the refusal to consent to assignment was proper, which may lead to court intervention (including provisional measures) and review. Thus, some clauses make attempts to replace an open-ended approach by stricter criteria. Financial responsibility and capability have already been mentioned (see

Section IV.H.3) as an example of such an objective and more specific standard. More examples have been found in assignment clauses:

> ". . . which consent shall not be withheld where the assigning Participant satisfies the other Participants that the proposed assignee has the financial and technical status and ability to observe and perform in a proper and timely manner the obligations to be assigned (it being understood that such consent may reasonably be withheld in the case of a proposed assignment to a competitor company)."

d. No Reaction Upon the Request for Consent

Few are the clauses that deal with the situation of the debtor/obligor not reacting to a request to consent to assignment. Only one of the clauses analyzed provided a solution to this problem by stipulating that the debtor's/obligor's failure to react is deemed to constitute consent:

> ". . . In the absence of such notification B shall be deemed to have consented to such assignment."

e. Consent Refused

Assignment clauses generally do not provide anything further for the situation arising from consent being timely and properly refused by the debtor/obligor. This may be explained psychologically. The parties do not generally want to state that the assignor then may seek remedies in a court having jurisdiction. Moreover, the dispute settlement clause in the contract may well already provide the techniques for settling disputes in general including disputes arising out of a refusal to consent.

f. Sanction Upon Non-Compliance

Assignment clauses only rarely provide sanctions in case of non-observance of the requirements set forth in the assignment clause. The following are examples of the few cases which deal with this problem:

- ". . . and any attempted assignment without such prior written consent shall be void ab initio."
- "Any attempted assignment of rights or delegation of duties not in conformity herewith shall be void and of no force or effect."

In one specific case, where a special assignment provision was drafted in order to restrict the assignability of deliveries of commodities sold, a draconian sanction was also provided in the contract:

> ". . . and in the event of any such attempted transfer, Seller, in addition to other legal rights and remedies, may cancel this Agreement

as to the unshipped portion of the Product covered by the Agreement."

Finally, in an exclusive distributorship contract, the following sanction was provided in the event the distributor were to assign the contract without the prior written consent of the manufacturer:

"Any assignment of this Agreement in contravention of this clause shall be null and void and constitute a default hereunder."

The sanction provisions in assignment clauses operate between the contracting parties. However, in many cases, the assignee will have seen the contract and have been or will be deemed informed about the requirement of the debtor's/obligor's consent. Therefore, the assignee may eventually also be liable for non-compliance under the conditions of the assignment clause, for instance on the basis of tortuous interference with the contract. These clauses, however, have foremost a deterrent function and may force both assignor and assignee to seek the debtor's/obligor's consent prior to effectuating the transfer.

4. *Exceptions to No-Assignment or Restrictive Assignment Clauses*

Prohibitions to assignment and restrictions on assignment are often subject to exceptions. A frequent exception to a no-assignment clause in international contracts is the *affiliate*-exception. Sometimes, other exceptions may be found and will be discussed hereafter.

a. The Affiliate Exception

Many assignment clauses expressly provide for the possibility of assigning the contract or the rights under a contract to an affiliate company. In that case, contracting parties may assign their rights under the contract or the contract itself by virtue of the affiliate-exception—notwithstanding the assignment clause—to a company being part of the same corporate group. This rather widespread exception is inspired by business reasons and stresses the importance of groups of companies in international business life. Companies generally in contracting want to reserve the possibility for group re-structurings (for instance for financial, tax or strategic reasons) and provide in their contracts that these are not to be assigned save to affiliate companies.

In some cases, the affiliate-exception is unconditional. In other cases, further requirements must be met:

- "Each of the Parties may, subject to . . . the provisions hereinafter contained, at any time upon notice to the other Parties assign all

or part of its said interest to an Affiliate of such Party which has demonstrated to the satisfaction of the other Parties its financial capability to meet its prospective obligations hereunder."

- "The Buyer may not without further consent assign the benefit and/or burden of this agreement provided that the Buyer may so assign to any of its Group Companies if it gives to the Seller a unconditional continuing guarantee of its obligations under the Agreement and any other agreements entered into hereunder in terms which are reasonably satisfactory to the Seller."

Sometimes, the consent of third parties (e.g., the banks involved in financing the transaction) is required:

> "The Buyer shall have the right at any time to sell, transfer or assign all the rights and/or the obligations that it has or may acquire under this contract to another corporation wherein it or Mr. X or Y is the main party, with the agreement of the government of Z and European financial authorities."

These affiliate-clauses raise the issue as to the effects on the contract if the subsidiary in any way (e.g., share sale, demerger) quits the corporate group. Many affiliate-clauses do not examine this issue. One clause did foresee this problem and made the assignment conditional on the affiliate remaining within the group:

> "Neither this Agreement nor any of the rights, interests, or obligations under this Agreement may be assigned by any party without the prior written consent of . . . , except that each party may assign, in its sole discretion, but without being released from its obligations hereunder, any or all of its rights or interests or performance of its obligations under this Agreement (other than those arising under Section 8) to any direct or indirect wholly owned subsidiary of such party and only as long as it remains a subsidiary."

The preceding clause does not characterize the condition made to the assignment nor does it provide what is to happen in case the subsidiary ceases to belong to the corporate group. The solution may be found in another case where re-assignment by the affiliate to the original assignor was provided for in case the affiliate were to leave the group of the original assignor:

> "Each Participant shall be entitled to assign any or all of its rights and obligations under this Agreement to an Affiliate of that Participant without the consent of the other Participants, provided that in such event the proposed assignee shall enter into an agreement with such other Participants to be bound by this Agreement,

> and such agreement shall include a legally enforceable covenant by the proposed assignee that it shall reassign this Agreement to the assigning Participant or to another Affiliate within the original assigning Participant's Group prior to ceasing to be an Affiliate within the assigning Participant's Group."

These clauses raise the problem of finding a proper definition of the term "affiliate." In view of differences in definitions in various countries, the contracting parties should consider defining the concept of affiliate. The necessity of finding an acceptable definition is confirmed by international contract practice where one sees many contracts in which either summary or extensive definitions of affiliate are given and which may, at times, appear in the definitional provision of the contract.[27]

b. Other Exceptions

Apart from the affiliate-exception, other exceptions have been found, for instance, relating to mergers and acquisitions:

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[27] The subject of the various definitions of affiliates falls outside the scope of this chapter. However, for information purposes, some definitions may hereafter be given as examples. For an extensive definition, see the following:

> "Affiliate shall have the meaning in relation to any Party, any company
>
> (a) in which a Party hereto owns directly or indirectly share capital conferring at least fifty percent (50%) of votes at stockholders' meetings; or
>
> (b) which is the owner directly or indirectly of share capital conferring at least fifty percent (50%) of votes at stockholders' meetings of a Party; or
>
> (c) whose share capital conferring at least fifty percent (50%) of votes at stockholders' meetings of such company and the share capital conferring at least fifty percent (50%) at stockholders' meetings of a Party are owned directly or indirectly by the same company."

Shorter definitions are more frequent:

> "'Affiliate' means a subsidiary company in which Owner owns fifty percent (50%) or more of the voting shares, or a parent company which owns directly or indirectly fifty percent (50%) or more of the voting shares of the Owner, or a subsidiary part of a parent as defined."

Finally, some clauses define the concept of affiliate by reference:

> ". . . which shall be a subsidiary of X as defined by section 736 of the (UK) Companies Act 1985 (as amended)."

or

> "However, this Agreement and the rights and obligations which arise hereunder can be freely transferred to those companies considered to be affiliated to a party to this Agreement under the rules of the Belgian accounting legislation."

- "This Contract is not assignable by either party without the prior written consent of the other party hereto, except that it may be assigned without such consent to the successors of either party or to a person, firm or corporation acquiring all or substantially all of the business and assets of such party."
- "This Agreement shall inure to the benefit of and be binding upon each of the parties hereto and shall be assignable to the successor to the entire business of either party relating to the subject matter of this Agreement."
- "Notwithstanding the preceding however, each party shall have the right to assign its rights hereunder without the other party's consent, to a successor to more than one half of its assets, or to a majority owned subsidiary or a majority owner of the assignor."
- "This Agreement may be assigned by B to one of its affiliated companies, but it shall not be otherwise assigned, transferred or sold, by any party without the prior written consent of the other except to an assignee of substantially the entire business assets of the assigning party hereto . . ."

Other clauses that mitigate the restrictions on assignment are inserted in contracts for commercial reasons:

- "At Seller's option, and without any requirement for Buyer's prior consent, Seller may assign this Agreement, including all its rights and obligations hereunder, to another party designated by Seller who shall have succeeded to Seller's right to sell the product produced from the reserves described in paragraph 2 of this Sales Agreement."
- "This Agreement and the benefit of the rights granted to the Distributor by this Agreement shall be personal to the Distributor who shall not without the prior consent of the Principal mortgage or charge the same to any third party nor subcontract nor assign the same nor part with any of its rights or obligations hereunder save that the foregoing shall not prevent the Distributor from factoring or mortgage or in any way creating a charge or security over Products the title in which shall have passed to it or over book-debts created by the sale of such Products."[28]

Finally, financing concerns may inspire contracting parties to provide exceptions to restricted assignment in favor of financial institutions:

- ". . . this Agreement shall be assignable by Buyer in whole or in part to a wholly-owned subsidiary or affiliate of Buyer or any financial

[28] Clause cited by R. Christou, *Drafting Commercial Agreements,* 2nd edition, London, Sweet & Maxwell, 1998, p. 316.

institution which is providing financing to Buyer in connection with Buyer's acquisition of the Aircraft . . ."

- ". . . provided, however, that C may pledge all or part of its interest in this contract to a bank or a financial institution in the ordinary course of its business and may assign all of its right, title and interest in and to this agreement to any party in the event that A is in default beyond any period provided for cure of such default of any of its obligations to C under this agreement without A's prior written consent."

The mere fact that assignment clauses provide for exceptions, as discussed above, does not necessarily imply that assignment is unconditional. However, the analysis of assignment clauses has revealed that clauses providing for exceptions to assignment prohibitions or restrictions tend to focus primarily on the definition of these exceptions and not so much on any requirements to be met in case of such an assignment. In this respect, the following clauses are rather unusual:

- "This Agreement . . . shall not be otherwise assigned, transferred or sold, by any party without the prior written consent of the other except to an assignee of substantially the entire business assets of the assigning party hereto and only if such assignee in writing agrees to assume such assigning party's obligations hereunder and to be bound by the terms and conditions hereof."
- ". . . , this Agreement . . . shall not be voluntarily assigned in whole or in part by either party without the prior written consent of the other party, provided, however, that no such prior consent shall be required for any assignment of this Agreement in its entirety by either party to a successor in interest of such party as a result of any merger or consolidation involving such party, or of a sale by such party of the entire business relating to the subject matter hereof, provided that said successor in interest or successor's parent company is not already manufacturing Licensed Products in Japan or is not manufacturing Licensed Products under a license from any third party manufacturing Licensed Products in Japan, and provided further that it agrees to undertake all the obligations of the assignor."

I. Partial Assignments

Assignment clauses do not always distinguish between complete and partial assignments. In some cases, however, partial assignments have been considered:

- "No assignment or transfer of any interest under the Licence or this Agreement shall be made by any Party otherwise than in

respect of an undivided interest in all or part of its interest in the Licence and in and under this Agreement . . ."

- "Neither Company nor Contractor shall be entitled to assign either in whole or in part any of its rights and obligations under the Contract without . . ."

J. Consequences of the Application of the Assignment Clause

Some, but far from all, assignment clauses pay attention to the effects of the assignment. To the extent they do, a distinction may be made between the effects of the assignment clause *vis-à-vis* the assignee, the assignor and the debtor/obligor.

1. *Consequences* Vis-à-Vis *the Assignee*

Since the consent of the debtor/obligor is often required for the assignment of contracts, the debtor/obligor may make his consent expressly conditional upon the assignee becoming liable under the contract in the same way as the assignor was. In this respect, many clauses are inspired by the following boilerplate clause:

> "The provisions of this Agreement shall enure for the benefit of and be binding on the successors in title and permitted assignees of the Parties."

Other language expresses the same idea:

> "When duly assigned in accordance with the foregoing, this Contract shall be binding upon and all rights and obligations hereunder shall be assumed by the assignee."

Often, this effect will already be produced by virtue of the law applicable to the assignment. In this respect, assignment clauses not only repeat the extent of the assignee's obligations under the applicable law but may function primarily to extend these obligations, for instance, regarding obligations existing at the time of the assignment (pre-assignment obligations). Any such extension requires the consent of the assignee. Thus, assignment clauses sometimes provide expressly for a mechanism in order to guarantee to the debtor/obligor that the assignee is bound by the contract. Thus, the following unilateral clause:

> "Any party to whom the rights and obligations under the Contract are transferred shall be bound by all the provisions of the Contract. Contractor shall procure as a condition precedent to any assignment that such assignment shall

a. be executed in accordance with the provisions of the Contract,

b. be executed contemporaneously with a separate specific agreement in favour and for the benefit of Company to the effect that the assignee accepts and agrees to be bound by the Contract, and

c. be of no force or effect whatsoever unless and until the provisions of this article have been met, and an executed copy of the agreement referred to in b. above has been delivered to Company as a precondition to granting the required written consent."

or the following bilateral clauses:

- "No assignment of this Contract shall be valid until and unless this Contract shall have been assumed in writing by the assignee."
- ". . . the assigning Participant shall provide to such other Participants a direct covenant by the proposed assignee (in favour of and in a form satisfactory to each other Participant) that, with effect from the effective date of the assignment, the proposed assignee shall observe and perform all the terms of this Agreement, as assigned to it; and such assignee shall be entitled to all of the rights and subject to all of the obligations of the assigning Participant to the extent so assigned, . . ."

Non-compliance with the conditions and procedures contained in these clauses may trigger the liability of the assignor. Less clear are the effects of any such violation on the assignee. In practice, however, the assignee will often have seen the contract including its restrictive assignment clause, and his liability may as well be invoked. Therefore, the safest way for both assignor and assignee is to comply with the provisions of the assignment clause. One might thus say that these clauses provide for the machinery to make the assignee accede to the existing contractual relationship.

2. *Consequences* Vis-à-Vis *the Assignor*

Less frequent are assignment clauses that regulate the effects of the assignment upon the assignor. The question is whether assignment clauses provide anything regarding the effects of the transfer of the contract on the obligations of the assignor under the contract. Is the assignor discharged, and from what moment on, or does the assignor remain liable with the assignee, either severally or jointly?

Since the obligor's consent is required to transfer the contract, the obligor may state his conditions before agreeing to the transfer. Assignment clauses, in this respect, are anticipatory clauses that determine the effects of the transfer of the contract upon the assignor if a transfer were to occur.

Considering the bargaining power of the contracting parties and the nature of the contract, a variety of contract clauses has been found. At one extreme of the spectrum, assignment clauses regarding the transfer of the contract (as opposed to the mere assignment of the rights) provide for or may be interpreted as joint liability for both assignor and assignee towards the debtor/obligor:

- ". . . provided the Buyer shall remain jointly and severally liable with the assignee for the fulfilment of all the terms and conditions of this Agreement."
- ". . . provided, further, that the assigning party shall remain jointly and severally liable for the performance of the obligations hereunder that are so assigned."
- "Any assignment of this Agreement by either party shall not relieve the assigning party of its duties or obligations hereunder."

or (in case of an assignment made in order to vest a security interest):

> "Any such assignment by way of security shall not relieve or in any way discharge Group from the performance of its duties and obligations under this Agreement."

In the preceding clauses, some do provide for joint and several liability where others do not determine the respective positions of the assignor and the assignee *vis-à-vis* the debtor/obligor. In one other clause, the issue was raised but—subject to further interpretation—remained unresolved as to the order in which to take recourse:

> "Notwithstanding any assignment of this Agreement, the assigning party shall remain primarily liable for all its obligations hereunder without any recourse being required to any such permitted assignee."

Sometimes a distinction is made regarding the moment the obligation was incurred. Pre-assignment obligations are then treated differently from post-assignment obligations as in this example:

> "A Party so assigning all or part of its said interest shall remain liable to the other Parties for all obligations attaching to the interests assigned pursuant to this Clause 21 which are incurred prior to the effective date of such assignment and such obligations shall in addition become the obligations of the assignee."

At the other end of the spectrum, some clauses provide for the assignor's discharge:

- "The Affiliate will thereafter be liable solely for the performance of Owner's obligations hereunder."

- "This License Agreement shall be assignable by Licensor without Licensee's prior consent provided the assignee receives all rights and properties possessed at the date hereof by Licensor which are pertinent to this License Agreement, and agrees to be bound in all respects in place of Licensor."
- "On the transfer being made, the original Bank shall be relieved of its obligations to the extent of the transfer of such obligation, the transferee shall become a Bank to the extent of the rights and obligations so transferred, for all purposes of this Agreement, and Annex I of this Agreement shall be amended accordingly."

3. Consequences Vis-à-Vis the Debtor/Obligor

Another issue concerns the position of the debtor/obligor upon assignment. In this respect, assignors, with strong bargaining positions, impose upon the debtor/obligor that he will remain liable under the contract:

> "Assignment of the Contract by Owner shall not relieve Contractor of any of his obligations or liabilities and Contractor hereby agrees to continue to perform all his duties and obligations under the Contract in the event of such assignment."

One may question whether these clauses are necessary, since, under many national laws, the transfer of the contract does not change the position of the debtor/obligor. The contract, as such, is being transferred and one party is substituted for another. However, one might argue that the clause cited above may be relevant if the assignee and the debtor/obligor re-negotiate the contract upon transfer. The clause may then be an argument in the re-negotiating process.

K. Warranties of the Assignor *Vis-à-Vis* the Debtor/Obligor and Indemnities

Generally, assignment clauses seldom provide for warranties to be given by the assignor to the debtor/obligor nor for indemnities to be paid in case of breach. There are two exceptions:

- "Si l'établissement exploité par le client est transféré pour une raison quelconque à un tiers, soit à titre de propriété, soit à titre de gérance, le client signataire du présent contrat répond de ce que les obligations en résultant soient transférées à son successeur.
  "Si cette obligation de transfert n'est pas respectée, il répond aussi pour les actes de ses successeurs."
- "Purchaser shall indemnify X, Seller and their Affiliates against, and hold each of them harmless from, any loss, claim, damage, liability or expense arising out of or relating to the assignment by Purchaser to a third party other than an Affiliate of Purchaser, of

all or any portion of its rights and obligations pursuant to this Agreement including, without limitation any increased liability for Taxes or Transfer Taxes.

"The indemnities provided for above shall be in addition to any liability that the respective parties may otherwise have under this Agreement and shall not be subject to the limitations provided in Sections 7.1, 7.2 and 7.3 hereof."

L. Costs Related to Assignment

Parties seldom provide for anything regarding the costs associated with the assignment. In one contract, however, the following clause was found dealing with this problem:

"All costs and expenses pertaining to any such assignment, including any stamp duty, shall be the responsibility of the assignor."

V. CONCLUSIONS

Assignment of rights and transfer of contracts are important to international business life. For contracts concluded *intuitu personae,* contracting parties use their autonomy to adapt their contracts to the features of their relationships. In this respect, assignment of rights but—more importantly—transfer of contracts have led to more or less extensive assignment clauses. In this respect, one may note a certain degree of standardization of assignment clauses due to the widespread use of boilerplate clauses.

For practitioners, the following suggestions may be helpful:

1. A clear distinction between assignment of rights and transfer of contract is to be recommended. Since both situations are regulated by different rules, one should distinguish in the assignment clause between them regarding their requirements, procedures and effects;
2. One might also want to distinguish between assignment of rights and transfer of contracts, on the one hand, and related mechanisms such as delegation, subrogation, novation and sub-contracting, on the other. Although many of these mechanisms are inspired by the same concern of preserving control over the *intuitu personae* character of the contract and thus, over the identity of the counter-party, the requirements, procedures and effects of these various mechanisms may differ. It might be advisable to identify more clearly in contract clauses these various hypotheticals;
3. In order to give assignment clauses a broad scope of application, one may suggest not only to bring voluntary assignments within

the scope of the assignment clause but also—to the extent permitted by the applicable law—compulsory assignments;

4. It is generally, for business and legal reasons, recommended to limit in time no-assignment clauses regarding transfers of contracts. As an alternative, restrictive assignment clauses could be considered;
5. Restrictive assignment clauses tend primarily to restrict and control transfers of contracts and provide procedures, conditions and standards under which contracts may be assigned. One should pay sufficient attention to the following issues: (1) what happens if the obligor does not respond to the assignor's request for consent? (see Section IV.H.3.d); (2) what happens if the obligor refuses consent? (see Section IV.H.3.e); and (3) what are the sanctions if the assignor does not comply with the provisions of the assignment clause? (see Section IV.H.3.f);
6. In restrictive assignment clauses, one should look closely to the criteria upon which the obligor may base a refusal to consent to a transfer of the contract. Discretionary criteria may seem to protect the obligor's interests but may still lead to challenges in court. Open-ended criteria (e.g., "shall not unreasonably be withheld") may prove flexible but are less certain. Objective parameters are rather rigid but provide for more stability;
7. Many assignment clauses provide for the possibility to assign the rights under the contract or to transfer the contract itself to affiliate companies. These clauses require a good definition of the affiliate concept. In this respect, one should also consider the hypothetical that an affiliate may cease to be part of a corporate group and consider whether this case should be covered by a special contract provision;
8. Assignment clauses may also consider the effects of mergers, demergers and acquisitions on the rights and contracts of a company and whether it is useful to provide an exception to restrictive assignment clauses for these cases;
9. Finally, the effects of assignment generally do not receive sufficient attention. Therefore, it is suggested that assignment clauses should consider whether specific provisions are to be included that outline the effects of the assignment on the assignee, the assignor and the obligor.

These suggestions certainly open perspectives for increased sophistication of assignment clauses in international commercial contracts.

CHAPTER 12

TERMINATION CLAUSES

I. WORK METHOD

True to its objectives, the Working Group looked at termination and synonymous clauses in international commercial contracts from the perspective of international contract draftsmen. On the basis of discussions and analyses of sample clauses provided by its members working in legal or contract departments of companies or working in private practice,[1] general

[1] The following termination clauses contained in international instruments should also be mentioned:

Articles 18 and 20 of the ICC Model Commercial Agency Contract, ICC Publication No. 644, Paris, ICC Publishing, 2002;

Articles 19 and 20 of the ICC Model Distributorship Contract, ICC Publication No. 646, Paris, ICC Publishing, 2002;

Chapter XXV—Termination of Contract of the Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works, UNCITRAL, U.N. Sales No. E.87.V.10, Doc. A/CN.9/SER.B/2, 1988;

Article 2.2.9—Postponement and Termination of the International Model Form of Agreement between Client and Consulting Engineer and International General Rules of Agreement between Client and Consulting Engineer for Pre-Investment Studies (IGRA 1979 P.I.), FIDIC, 3rd ed., 1979; Article 2.2.9—Postponement and Termination of the International Model Form of Agreement between Client and Consulting Engineer and International General Rules of Agreement between Client and Consulting Engineer for Project Management (IGRA 1980 PM), FIDIC, 1980; Article 2.2.9—Postponement and Termination of the International Model Form of Agreement between Client and Consulting Engineer and International General Rules of Agreement between Client and Consulting Engineer for Design and Supervision of Construction of Works (IGRA 1979 D&S), FIDIC, 1979, all replaced by the Client/Consultant Model Services Agreement—The White Book, FIDIC, Lausanne, 2nd ed., 1991;

Conditions of Contract for Electrical and Mechanical Works—The Yellow Book, FIDIC, Lausanne, 1st ed., 1963 (clauses 41–47), 2nd ed., 1980 (clauses 44–48 and 51), 3rd ed., 1988 (clauses 33 and 44–46);

Conditions of Contract for Works of Civil Engineering Construction—The Red Book, FIDIC, Lausanne, 2nd ed., 1969 (clauses 63, 65–66, 69), 3rd ed., 1977 (clauses 63, 65–66 and 69), 4th ed., 1989 (clauses 63, 65 and 69); (In 1999, new FIDIC conditions were published. The old conditions are cited in this chapter by way of example only to the extent that they express original solutions).

Conditions Générales AFB pour les opérations d'échange de devises et/ou de conditions d'intérêts, Association française des Banques, March 1987;

trends and problems regarding these clauses were observed. This chapter attempts to provide a summary of the discussions and analyses. This is therefore an analytical description, which has the advantage of giving extensive attention to the various elements of these clauses. However, to understand termination clauses, an overall perspective is also needed including their various elements, other contract clauses[2] and the factual background of the circumstances under which these clauses have been or are to be used.

Attempts to classify termination clauses (see Sections IV.E. through IV.M) may create the false impression that all termination clauses fall within one of these categories, but classification only facilitates a better understanding of the various options available to contracting parties and is not intended to be comprehensive.

Finally, one should note that termination clauses in international commercial contracts tend to be standardized to a certain extent, with similar contents and wording. However, one cannot characterize termination clauses as boilerplate clauses that are copied from one contract to another not only within the same company or law firm but also across the legal profession. Indeed, the degree of standardization of termination clauses is less pervasive than for some other clauses (e.g., interpretation and assignment clauses[3]). The reason for the more tailor-made nature of termination clauses is that they are related to the core of the contract. Often, these termination clauses sanction breaches regarding fundamental contractual obligations or express circumstances under which the parties no longer wish to continue their contractual relationships. Because of their importance, termination clauses are the subject of negotiations between parties to one-off contracts. Bargaining power and strategies also determine the contents of the termination clause and an imbalance to which a party is forced to agree regarding one part of the termination clause is sometimes set off by modification to another part of the termination clause. This explains the great variety of termination clauses one finds in international commercial contracts.

Code of Standard Wording, Assumptions and Provisions for Swaps, 1986 ed., International Swap Dealers Association, 1986 and International Swap Dealers Association Master Agreement;

International Foreign Exchange Master Agreement.

[2] See, for instance, the relationship between termination and certain assignment clauses mentioned by Mousseron (*Technique contractuelle*, Paris, Lefebvre, 2nd ed., 1999, pp. 229–230). In those particular examples, the transfer of the contract by the assignor entitled the obligor to terminate the contract in order to avoid contractual relationships with the assignee.

[3] See *supra* Chapters 3 and 11.

II. INTRODUCTION AND DEFINITIONS

Termination of contracts is a well-known problem in international business life. As to the law on termination, many civil law countries have statutory rules on the subject.[4] These rules generally deal more with termination of the obligations stemming from the contract than with the termination of the contract itself. Legal scholarly writings therefore had to fill this gap and provide a conceptual background for contract termination. In codifications and legal literature, one can generally find rules on the grounds for termination as well as the requirements and the effects of termination on the obligations and the contract itself. In common law jurisdictions there are few statutory rules on termination, while established precedents offer solutions to demanding problems. In addition to national rules, there are also uniform texts that contain provisions relevant to contract termination. In this respect, one may note the many uniform texts in the field of transport law and the Convention on the International Sales of Goods 1980 (CISG), the latter now in force in over 60 countries. Finally, in international commercial arbitration, some persuasive authority for resolving disputes about termination has been established in the Unidroit Principles for International Commercial Contracts[5] and in the Principles of European Contract Law.[6] However, these Principles and other sources of *lex mercatoria* will, as such, not be able to settle termination disputes completely, and, in general, termination disputes between companies will also have to be solved by reference to national law.[7]

Before discussing the scope of this chapter, here are some terminological indications. Since grounds for termination of obligations and contracts may differ among jurisdictions and no universal terminology is available, this chapter will use the generic terms of *termination clauses* and *termination of obligations and contracts.* Where useful or necessary, further distinctions as to the grounds for termination will be made.

III. SCOPE OF THE CHAPTER

Because of the vast range of issues regarding termination, some restrictions were made in order to limit the scope of the project. First, the analy-

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[4] Differences in terminology among the various jurisdictions regarding termination is a factor that complicates work in this area.

[5] *Principles of International Commercial Contracts,* Rome, Unidroit, 2004, 385 pp. For the most extensive commentary, see M.J. Bonell, *An International Restatement of Contract Law, The Unidroit Principles of International Commercial Contracts,* 2nd ed., Irvington N.Y., Transnational, 1997.

[6] Commission On European Contract Law, *The Principles of European Contract Law,* O. Lando, & H. Beale, (eds.), The Hague, Kluwer Law International, 2000, 561 pp.

[7] This may be different in State contract-litigation where States and public enterprises are involved.

sis dealt only with general problems of the law of contract and obligations regarding termination. Special contracts that, under the applicable law, may be affected by special considerations or governed by specific provisions (e.g., mandatory rules on termination of commercial agents,[8] mandatory rules on protection of employees against dismissal, protection of consumers against termination of contracts,[9] provisions in insurance law relating to termination of insurance contracts, termination of contracts regarding intellectual and industrial property rights, termination clauses related to legislation or regulations regarding public procurement projects) were not included in the analysis.

Furthermore, termination clauses in international commercial contracts are often influenced by the nature of these contracts. This has been covered in this chapter to the extent that contract practice reflects the features of these specific contracts and to the extent that clauses expressing these features have been encountered in the process of the analyses and discussions of the Working Group. For instance, distribution agreements, license agreements[10] and financial agreements contain specific termination provisions that may be more detailed or more specific than termination clauses in other international commercial contracts. These have also been included in this chapter under the two qualifications mentioned above.

Furthermore, competition law (including merger control law) aspects of termination clauses have also been left out of this Chapter, notwithstanding their importance and the frequency of competition-law-sensitive provisions in termination clauses.

Finally, the analysis was restricted to clauses in international contracts regulating termination, thus excluding *termination contracts* that parties may conclude after termination of their business relationship (for instance, in the course of a settlement) and in which the effects of the termination are dealt with.

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[8] For the European Union, see the harmonization achieved by Directive 86/653 of December 18, 1986 on the coordination of the legislation of the member States regarding commercial agents, OJ L. 382 of December 31, 1986, 17–21. Other civil law countries have often similar rules providing some protection for commercial agents in case of termination of commercial agency contracts.

[9] E.g., statutory provisions regarding consumer credit contracts or general conditions which restrict possibilities to terminate consumer contracts. For the harmonization of the law on general conditions within the European Union, see Council Directive 93/13 of April 5, 1993 regarding unfair contract terms in consumer contracts, OJ L. 95, April 24, 1993, 29–34.

[10] For a discussion regarding these contracts, see J.M. Mousseron, *op. cit.*, pp. 615–676 with further references.

Because of the many differences both in terminology and in substance of national laws regarding termination, it was unanimously decided that the project could not go forward without national reports describing termination rules in some major jurisdictions.[11] Some members of the Group were asked and accepted to provide such reports. In relation to termination law, reference is made to these reports on Belgian, Dutch, English, French, German, Italian, Spanish and Swiss law.[12]

IV. ANALYSIS OF TERMINATION CLAUSES IN INTERNATIONAL CONTRACTS[13]

A. General Observations

Termination clauses cover a wide range of different situations including the possible termination of contracts as a result of:

1. nullity and voidability;
2. the effect of a condition subsequent;
3. an agreement by the contracting parties to terminate the contract (*mutuus dissensus*);[14]
4. the performance of the contractual obligations;

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[11] National rules are particularly relevant in international commercial contracts. This raises the conflict of laws issue as to the law applicable to termination questions. Generally, the law governing contractual termination issues will be the law that applies to the contract (*lex causae*). For the European Union, the basis for this solution is set forth in Article 10 of the Rome 1980 Convention on the Law Applicable to Contractual Obligations (OJ L. 266, October 9, 1980, 1–19).

[12] These reports have been published in *I.B.L.J.* 1997, 837–937 as annexes to the original publication of the report on termination clauses. Adde: B. Mercadal, *Contrats et droits de l'entreprise*, 10th ed., Paris, Lefebvre, 2002, pp. 357–411; I. Cherpillod, *La fin des contrats de durée*, Lausanne, CEDIDAC, 1988, 275 pp.; *La cessation des relations contractuelles d'affaires*, Institut de Droit des Affaires, Aix-en-Provence, Presses Universitaires D'Aix-Marseille, 1997, 232 pp.; J. Gruber, *Die Befugnis des Darlehensgebers zur Vertragsbeendigung bei internationalen Kreditverträgen*, Bielefeld, Gieseking, 1997, 354 pp.; A. Brabant, *Les marchés publics et privés dans la C.E.E. et outre-mer*, Vol. I, Brussels, Bruylant, 1992, pp. 518–540.

For a comparative overview, see G.H. Treitel, Remedies for breach of contract, in *International Encyclopedia of Comparative Law*, The Hague, Mouton, 1976, 185 pp.

[13] See on this subject: J.M. Mousseron, *op. cit.*, 615–676; B. Mercadal, *op. cit.*, pp. 396–397 and 405–410; A.G.J. Berg, *Drafting Commercial Agreements*, London, Butterworths, 1991, 134–137; R. Christou, *Boilerplate Practical Clauses*, London, Financial Times Law & Tax, 2nd ed., 1995, pp. 35–48; D. Blanco, *Négocier et rédiger un contrat international*, Paris, Dunod, 1993, pp. 170–176; *La fin du contrat*, Association belge des Juristes d'Entreprise, Brussels, 1993, 296 pp.

[14] The termination agreement may not only follow from a new agreement between the contracting parties but also from a contractual termination mechanism. For an example of the latter, see the termination mechanisms in joint venture contracts related to deadlock (see the report on deadlock clauses in F. De Ly, Divorce Clauses in International Joint Venture Contracts, *I.B.L.J.*, 1995, pp. 294–295 and 311–313).

5. definite impossiblity to perform resulting from *force majeure*,[15] frustration or hardship;[16]
6. default of a contracting party constituting a breach of contract and entitling the other party to have the contract terminated;
7. the passing of the period for which the contract has been concluded in case of fixed term contracts;
8. notice given by one party to the other party in case of contracts concluded for an indefinite period;
9. some objective circumstances such as death of a contracting party[17] or a party's involvement in insolvency, bankruptcy or similar proceedings.

This list of events or circumstances amounting to a termination of contracts is not exhaustive[18] but reflects termination grounds that may be found in many jurisdictions of both a civil and a common law background. To a large extent, these national laws on termination do not impose mandatory rules regarding contract termination, which means that the contracting parties may themselves clarify or modify termination aspects of their contractual relationship. The following will show to what extent contracting parties in international commercial contracts actually adapt national laws regarding termination aspects of their contracts in order to meet their respective needs. To the extent that some termination grounds have already been discussed in previous reports of the Working Group (particularly in relation to *force majeure* and hardship), readers are referred to those chapters. One should also note that the existence of extensive legal rules on termination in statutory instruments or in case law already provide a framework for contract regulation. Consequently, contract draftsmen tend to adapt or depart from these rules in view of the specific requirements of individual contracts rather than to re-write them in terms of contractual provisions.

Since termination clauses are related to a variety of termination causes, all with their own features, the discussion hereafter will have to distinguish between these various grounds for termination (Sections IV.F through

[15] See *supra* Chapter 8.

[16] See *supra* Chapter 9.

[17] This is related to physical persons as counter-parties to contracts. In international commercial contracts, counterparties are, however, mostly legal persons. Therefore, this termination basis will not be discussed in this chapter. No contractual provisions to that effect have been found in the clauses that were the subject of the analysis.

[18] In the national reports published with the original report, some other causes were established (see *I.B.L.J.*, 1997, 837–937). In this respect, one may cite grounds such as repudiation of contracts, cancellation of contracts, voidance of contracts and termination based on anticipatory breach (for the latter, see M. Vanwijck-Alexandre, La résolution du contrat sur base de l'inexécution anticipée, *I.B.L.J.* 2002, pp. 407–422).

IV.M). This analytical method has the advantage that the various termination mechanisms are better identified and described with emphasis on these particular features. This approach, however, isolates the various aspects of termination clauses therefore sketching only an incomplete picture, since many termination clauses bring together several termination grounds. The following example taken from the FIDIC Red Book[19] illustrates this mixture of various termination grounds: breach of contract, hardship and objective terminating events:

> "In the event of the Employer:
>
> (a) failing to pay to the Contractor the amount due under any certificate of the Engineer within 28 days after the expiry of the time stated in Sub-Clause 60.10 within which payment is to be made, subject to any deduction that the Employer is entitled to make under the Contract, or
>
> (b) interfering with or obstructing or refusing any required approval to the issue of any such certificate, or
>
> (c) becoming bankrupt or, being a company, going into liquidation, other than for the purpose of a scheme of reconstruction or amalgamation, or
>
> (d) giving notice to the Contractor that for unforeseen reasons, due to economic dislocation, it is impossible for him to continue to meet his contractual obligations
>
> the Contractor shall be entitled to terminate his employment under the Contract by giving notice to the Employer, with a copy to the Engineer. Such termination shall take effect 14 days after the giving of the notice."

For that reason, the examples cited hereafter may not be seen as sample termination clauses but are used only to illustrate the various elements that have been found in the termination clauses analyzed. It is sometimes difficult to characterize termination grounds in order to determine in which category terminating events are to be placed. Moreover, this characterization process is often complicated by terminological imprecision on the part of contract draftsmen. Before discussing the different termination grounds any further, some common characteristics of termination clauses will be analyzed (Sections IV.B through IV.E).

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[19] Clause 69.1 (Default of Employer) of the Conditions of Contract for Works of Civil Engineering Construction—The Red Book, FIDIC, Lausanne, 4th ed., 1989.

Finally, another general observation should be made. A growing tendency has been noted with contract negotiators and draftsmen, particularly in contracts with parties of similar bargaining power, to look—much less than used to be the case—to termination not from the perspective of the causes of termination and who is to blame for termination, but rather when and how termination is to be achieved. This more objective approach had already been noted in the report on deadlock and divorce clauses in international joint venture contracts[20] and has been found here also, albeit to a much lesser degree. This difference might be explained by the fact that joint venture contracts are typically longer term cooperation contracts generally involving huge interests on both sides where it is important to find out ways that are acceptable to both parties. In such a configuration, one is more inclined to draft the contract in terms of problem solution rather than in terms of blame and responsibilities. This same approach sometimes exists in termination clauses of other international commercial contracts:

> "Si les licences d'exportation n'étaient pas obtenues . . . l'Acheteur serait en droit de résilier le Contrat en totalité ou en partie."

or

> "Si les deux parties reconnaissent que les défauts, visés au point 14.14, dans certains types de l'équipement ne peuvent être éliminés, ou si, pour les éliminer, il faut plus de 6 mois, l'Acheteur aura le droit de renoncer aux parties correspondantes du Contrat. Dans ce cas, le Vendeur est obligé de rembourser à l'Acheteur la valeur de l'équipement livré et de payer une pénalité de x% du montant de la partie résiliée du Contrat."

B. Headings

Various headings are used for termination clauses. In the clauses, which were analyzed, these were found:

> Termination, Postponement and Termination, Termination and Cancellation, Default, Default and Liquidation, Résiliation, Interruption of the Loan—Events of Default, Exigibilité anticipée, Acceleration of Maturity, Résiliation en Cas de Défaut, Discontinuation due to Contractor

These headings indicate that (1) the various grounds for termination are not always clearly distinguished; or (2) in some cases, all termination grounds are brought together in one single termination clause.

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[20] F. De Ly, Divorce clauses in international joint venture contracts, *I.B.L.J.*, 1995, pp. 291–294.

C. The Location of Termination Clauses in the Contract

Termination clauses do not have a fixed place in the contract but are generally placed towards the end of the contract before the boilerplate clauses. Mostly, termination clauses are clearly identifiable contract clauses that deal only with termination.

One might add that termination is sometimes, particularly in finance agreements, also mentioned in the *Representation and Warranties* part of the contract. In that respect, at least one of the contracting parties states that events of default or termination events enumerated in the termination clause do not exist at the time of the formation of the contract. This aspect will not be covered in this chapter.

D. Relationship of Termination Clauses to Other Contracts

Often, international commercial contracting does not merely involve one single contract but several inter-related contracts may be concluded. Sometimes, this is referred to as *contract groups* (*groupe de contrats*). In that case, termination clauses may refer to previous contracts, contracts that are to be concluded at a later point in time or other contracts concluded with other parties such as group companies or sub-contractors. With regard to public procurement, a pre-bid agreement contained the following termination clause:

> "The Pre-Bid Agreement shall terminate on any of the following occurrences:
>
> . . .
>
> b) Failure of the Parties to agree upon the wording of the Joint Venture Agreement, or
>
> . . .
>
> d) The Contract being awarded to a third party, or
>
> . . .
>
> f) The conclusion of the Joint Venture Agreement as per Clause 4 hereof. . . ."

In sub-contracting agreements, provisions may be inserted in order to specify the effects of the termination of the main contract upon the sub-contract:

> "Le présent contrat est résilié de plein droit et sans aucune formalité:

> — lorsque le marché principal est lui-même résilié sans qu'il y ait faute de l'entrepreneur principal.
>
> Dans ce cas, aucune indemnité n'est due de part ni d'autre. Toutefois, dans le cas où une indemnité est versée par le maître de l'ouvrage à l'entrepreneur principal, celui-ci est tenu de répartir entre les sous-traitants concernés, en proportion du préjudice qu'ils ont subi, la part d'indemnité correspondant au préjudice retenu par le maître d'ouvrage pour les travaux sous-traités."

E. Unilateral and Bilateral Termination Clauses

Termination clauses may be unilateral or bilateral. Unilateral termination clauses entitle only one of the contracting parties to terminate if the termination event occurs. This may be related to the nature of the contract, as for instance, termination of contracts upon failure to proceed with the fee payment mechanism:

> "The Contractor shall also be entitled to terminate the Contract by giving 28 days notice to the Engineer and the Employer in any case where the Engineer has failed to issue a certificate of payment upon proper application by the Contractor."[21]

Unilateral termination clauses may also give indications as to the parties' bargaining position in negotiating the contract. Public procurement contracts in some countries do frequently provide for termination by reason of causes related to the performance of the contract by foreign companies, but do not state anything regarding termination related to the performance of the contract by the procuring public authority.

Bilateral termination clauses entitle either party to terminate the contract upon the occurrence of a certain termination event. Bilateral termination clauses may be symmetrical or asymmetrical. They are symmetrical if the termination clause treats both parties alike. In asymmetrical clauses, a distinction is made between the position of the parties. The different treatment of a party is often based on their respective bargaining power.

F. Nullity and Voidability

Contract clauses seldom provide for the termination of the contract as a result of its nullity or voidability. This can probably be explained by the fact that rules on contract formation were traditionally considered mandatory, and contracting parties could not, by agreement, vary these rules or

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[21] Clause 33.7, last paragraph of the FIDIC Yellow Book (Conditions of Contract for Electrical and Mechanical Works, 3rd ed., 1988).

their effects. This traditional view is open to challenge but little research has been done regarding this issue.[22] Contractual clauses regarding nullity or voidability of the contract were present in a limited number of cases. In a first clause, the termination provision dealt with the termination effects regarding bribery and corruption in a turn-key contract between commercial companies:

> "Any commission, advantage, gift, gratuity, reward or bribe given, promised or offered by or on behalf of the Contractor or his agent or servants or any other person on this or their behalf to any officer, servant, representative, or agent of the Owner, the Architect, or the Project Manager or their Representative, or to any person on their behalf or any of them in relation to the obtaining or to the execution of this or any other Contract with the Owner may in addition to any criminal liability which may be thereby incurred subject the Contractor to the cancellation of this and all other Contracts which he may have entered into with the Owner and also to the payment of any loss or damage resulting from such cancellation. The Owner shall be entitled upon a certificate in writing from the Project Manager to deduct the amounts so certified from any monies otherwise due to the Contractor under this or any other Contract Agreement or to recover the said amounts as a debt due or partly the one, and partly the other as the Owner shall deem advisable."

In another case, a finance agreement provided that no early withdrawals could be made from the credit facility

> ". . . if any statement made in this Loan Agreement or at the time of its performance misleads the LENDERS in their application of any substantial element of the BORROWER'S situation; . . ."

In yet another finance agreement, the *acceleration clause* of a loan (i.e., the provision according to which the loan or credit becomes due and payable prematurely—*clause d'exigibilité anticipée*) is set in operation

> "Si l'un des évènements suivants venait à se produire, à savoir:
>
> . . .

[22] For one of the rare extensive discussions, see R. Moser, *Vertragsabschluß, Vertragsgültigkeit und Parteiwille im internationalen Obligationenrecht*, St. Gallen, Verlag der Fehr'schen Buchhandlung, 1948, 253 pp. On this question, see also Chapter 1, pp. 34–54; Chapter 3, pp. 146–168; and Chapter 7, pp. 353–356 and 387–388.

> c) que l'une des déclarations faites par l'EMPRUNTEUR ou toute attestation, engagement ou document signé par un représentant de l'EMPRUNTEUR se révèle inexact sur un point important; . . ."

G. Condition Subsequent

Contract termination may be related to the intervention of uncertain events in the future, which the parties have foreseen and the occurrence of which are contractual grounds for termination (condition subsequent, *condition résolutoire*). In the context of public procurement, these conditions subsequent are often related to decisions by the contracting public authority as to the adjudication of the public works or the approval of sub-contractors. The following is such an example:

> "The Agreement will be terminated:
>
> 1. at the time the Parties hereto have entered into and signed the final Joint Venture Agreement referred to in Clause 7 of the Agreement.
>
> . . .
>
> 3. if the Joint Venture is not successful in being awarded the Contract, at the time when the Employer has issued a statement that the Contract has been awarded to another Tenderer or that the Employer has abandoned the project and, in either event, the tender bond, which is to be supplied by the Joint Venture, has been returned.
>
> And at the latest, twenty four months after the date of signature hereof."

Conditions subsequent automatically terminate the contract, which forces the contracting parties to conclude a new contract if they should want to do so. This may cause problems if one of the parties should want to break the contract and re-negotiate the contract terms. In order to obtain more flexibility and to continue working within the existing contractual framework, the following adaptation or modification clause had been inserted into a termination clause:

> "Dans le cas où la soumission serait annulée et un nouvel appel d'offre lancé dans le délai de 12 mois après la date de la première soumission, les Associés seraient engagés par le présent accord comme s'il n'avait pas pris fin. Ce délai pourra être prolongé d'un commun accord des trois Associés."

H. Termination by Mutual Consent (*Mutuus Dissensus*)

Under the rules of contract law, the parties may not only freely conclude contracts but may also terminate them by mutual consent. There are few termination clauses that deal with this possibility. This is probably to be explained by the fact that the parties at the time of contracting do not pay attention to this possibility since it is obvious that also, at a later date, during the life of the contract, they may still come to an agreement to terminate it. One of the few examples reads as follows:

> "Furthermore, if both parties upon testing of the modified automatic press for X's own use find that the marketing of such modified automatic press is not a viable project then this agreement may be terminated by mutual consent."

One may question whether this contract clause has any additive value but for the affirmation of the legal principle that parties by consent may terminate contracts.

I. Performance

Contracts are also terminated if all the contractual obligations have been performed. Termination clauses, however, seldom provide anything about termination by performance. The following clause is an exception:

> "12.1. This Agreement shall come into force on the date of signature hereof and shall terminate in the event of any one of the following circumstances occurring:
>
> 12.1.1. If the Contract has been entered into and has been fully implemented by the Joint Venture Partnership and the Employer when all rights and obligations as well as guarantees and liabilities of the Joint Venture Partnership have ceased and/or have been finally settled with the employer and any Third Party, and all rights and obligations between the Parties in connection with this Agreement have been finalized, and all differences or disputes between the Parties in connection with this Agreement have been finally settled. . . ."

Sometimes, contract clauses provide procedures to determine if and when the contract has been fully completed and then terminated. For instance, clause 62.1 (Defects Liability Certificate) of the FIDIC Red Book[23] stipulates as follows:

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[23] Conditions of Contract for Works of Civil Engineering Construction—The Red Book, FIDIC, Lausanne, 4th ed., 1989.

> "The Contract shall not be considered as completed until a Defects Liability Certificate shall have been signed by the Engineer and delivered to the Employer, with a copy to the Contractor, stating the date on which the Contractor shall have completed his obligations to execute and complete the Works and remedy any defects therein to the Engineer's satisfaction."

J. Breach of Contract[24]

Under general contract law in many jurisdictions, a court or arbitral tribunal may terminate the contract if either party defaults in relation to the performance of its contractual obligations when there is no excuse for such non-performance (such as *force majeure*). In many jurisdictions, termination is, however, not automatic and the court has some discretion in assessing whether the contract is to be terminated. Furthermore, the contracting party asking for termination generally has to observe a number of substantive and formal requirements before a court may grant its demand for termination. In one sample, this system has been followed expressly by an asymmetric termination provision under which default on the part of a contractor led to automatic termination of the turn-key contract. The contract provided as follows regarding default of the owner of the premises:

> "For reasons described in Subclause 68(1)b, the Contractor shall not be entitled to terminate his Contract, unless the Owner is judged to be in default by arbitration in accordance with the rules of arbitration specified under Clause 66 herein."

Court intervention in the termination process will slow down that process and has the disadvantage that it is uncertain and unpredictable whether termination will ensue. These drawbacks do not appeal to businessmen, particularly in international commercial transactions. For these reasons, contract practice has developed the technique of express termination terms (*clauses résolutoires expresses*).

The following is an example of such a terminating provision, which is drafted broadly encompassing a breach of any obligation under the contract:

> "In the event that either of the Joint Venturers . . .
>
> (b) shall be in breach of its obligations under Clause 6 hereof or any other of its obligations under this Agreement . . . then and in any such event the other Joint Venturer . . . shall have the following rights . . .

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[24] See *Les sanctions de l'inexécution des obligations contractuelles. Etudes de droit comparé*, M. Fontaine & G. Viney (eds.), Paris/Brussels, L.G.D.J./Bruylant, 2001, 1097 pp.

(i) to terminate the Joint Venture and this Agreement . . ."

or

> "Chacune des Parties aura la faculté de résilier tout ou partie du Contrat en cas de violation par l'autre Partie de ses prestations."

Termination clauses sometimes contain lists of terminating events. Regarding breach of contract, such clauses enumerate the violated obligations that may trigger the application of the termination clause. These clauses may be unilateral, bilateral and symmetric or bilateral and asymmetric. Where the bargaining power of one of the contracting parties is strong, for instance, regarding public procurement with many competitors, the procuring authorities are able to make long lists of causes for breach justifying the termination of the contract. In this regard, one analyzed contract contains a four-page termination clause with 14 terminating events. In the banking business, one also finds extensive termination clauses enabling the bank or other financial institution to terminate the contract immediately or to terminate any facility and accelerate re-payment upon the occurrence of certain enumerated events of default. Such a list is usually very long in international financial agreements and may take many pages. In that context, an event of default will normally trigger the operation of the *acceleration clause.* Any such mechanisms are strictly enforced and certain contracts provide expressly that the borrower does not have any defense against the request for full and immediate repayment:

> ". . . whereupon all those amounts shall become immediately due and payable, all without diligence, presentment, demand or payment, protest or notice of any kind, which are expressly waived by the Borrower."

Sometimes, contract provisions determine that a mere single breach does not suffice to trigger the application of the termination clause:

- "If the Contractor is not executing the Works in accordance with the Contract or is neglecting to perform his obligations thereunder so as seriously to affect the carrying out of the Works, the Engineer may give notice to the Contractor requiring him to make good such failure or neglect."[25]
- ". . . if the Engineer certifies to the Employer, with a copy to the Contractor, that, in his opinion, the Contractor:

[25] Clause 45.1 (Notice of Default) of the FIDIC Yellow Book (Conditions of Contract for Electrical and Mechanical Works, 3rd ed., 1988).

"(d) . . . despite previous warning from the Engineer, in writing, is otherwise persistently or flagrantly neglecting to comply with any of his obligations under the Contract, . . .
then the Employer may, after giving 14 days' notice to the Contractor, enter upon the Site and the Works and terminate the employment of the Contractor without thereby releasing the Contractor from any of his obligations or liabilities under the Contract, or affecting the rights and authorities conferred on the Employer or the Engineer by the Contract, . . ."[26]

- "L'Administration sera en droit de procéder à la résiliation de ce Contrat en cas de carence grave de l'Entrepreneur dans l'exécution des obligations qui lui incombent selon les stipulations de ce Contrat et ce, à l'expiration d'une mise en demeure donnée par lettre recommandée et restée sans effet dans un délai de 30 (Trente) jours . . ."
- "La Banque pourra à tout moment mettre fin unilatéralement aux obligations résultant pour elle de la présente Convention . . . dans les cas suivants:
  "— Pour le cas où l'Emprunteur ne paierait pas à une date d'échéance quelconque toutes sommes dues au titre de la présente Convention, à moins que cette défaillance ne se poursuive pas au-delà d'un délai de 10 jours. . . ."

The latter example, frequently included in finance agreements, is preferable to the open criteria regarding the seriousness of the breach of the other above-mentioned clauses (*seriously to affect the carrying out of the Works, persistently or flagrantly neglecting to comply, carence grave*). A strict criterion (such as a period of continuing breach) is, however, easier to use and define for payment obligations than for other obligations where the breach itself is more difficult to establish and to assess. Bank documents furthermore often allow a grace period for interest payments but not for capital.

Very often, termination clauses provide some formal requirements for any such termination in case of non-performance due to breach of contract:

- "La Partie qui invoquerait une telle violation notifiera à l'autre Partie par lettre recommandée avec accusé de réception . . ."
- ". . . if the Employer does not pay to the Contractor any amount properly due under clauses 31.1 and 31.2 within 14 days and continues such default for 7 days after receipt by registered post of a notice from the Contractor stating that notice of termination

[26] Clause 63.1 (Default of Contractor) of the Conditions of Contract for Works of Civil Engineering Construction—The Red Book, FIDIC, Lausanne, 4th ed., 1989.

under clause 28 will be served if payment is not made within 7 days from receipt thereof; . . ."

Because of the immediate and possibly harsh effects of the operation of these clauses, provisions have been inserted that allow the defaulting party to remedy its breach. These rights to cure, which are also known in some national laws (e.g., the *Nachfrist* in German law or relief against forfeiture in English law), provide the conditions and periods within which the defaulting party is to remedy its breach:

> "In the event that either of the Joint Venturers . . . shall be in breach of its obligations . . . and shall not remedy such breach within twenty eight days after having been required by the Management Board in writing to remedy such breach then . . ."

Some clauses deal with the problem of subsequent contract breaches. In practice, this may be important, since a party may, under the applicable national law, be required to react immediately upon the occurrence of any such breach in the absence of which he may be deemed to have waived his right to invoke the breach and the termination of the contract. Two examples of any such clauses can be given:

- "If the Contractor either shall continue such default for 14 days after receipt of such notice or shall at any time thereafter repeat such default (whether previously repeated or not) then the Employer may within 15 days after such continuance or repetition by notice by registered post forthwith terminate the employment of the Contractor under this Contract, provided that such notice shall not be given unreasonably or vexatiously."
- "In no event may any delay in exercising the LENDERS' right to require advance repayment be interpreted as a waiver of this right."

K. Passing of a Fixed Period

Under national law, fixed term contracts terminate automatically by operation of law upon the passing of the period for which they were concluded. Termination clauses in international commercial contracts often apply this rule, sometimes in combination with other termination grounds:

- ". . . this agreement shall (unless extended by mutual agreement) expire or terminate at the earliest of the following events:
  (a) one (1) year after the date of this agreement or
  (b) thirty (30) days after written notice of termination provided by either party to the other."
- "This Agreement shall remain in force from the Effective Date (as defined in Article 13 hereof) until the Completion Date . . ."

- "This Authorization Agreement expires on __________ unless on or before that date Buyer . . ."

Termination clauses sometimes regulate the effects when the contracting parties continue to execute the contract notwithstanding its expiration. These clauses may provide that a new contract for an identical period is deemed to be concluded (*evergreen clauses*) or that the contract will continue to exist for an indefinite period.[27]

L. Termination at Will[28]

Under some national laws, certain special category contracts may be terminated at will. For instance, in France and Belgium some construction contracts may be terminated by the owner under Article 1794 of the French and Belgian Civil Codes. Termination clauses sometimes adopt this technique and make it a contractual termination ground even if the governing law is not French or Belgian or if the statutory requirements of these laws are not met. The following is an example of such a termination clause in an engineering contract:

> "In addition to COMPANY's right set forth in article 17 COMPANY has the right at any time, at its absolute discretion, to terminate the CONTRACT without any notice of default or judicial intervention being required for the purpose."

Similar termination-at-will-clauses have been encountered in other contexts. For instance, in an agreement between consortium partners intending to bid for a public procurement project, either partner had the right not to join in the tender:

> "Furthermore, either Party has the right to recede from this Agreement, on receipt and after review of tender documents . . ."

Furthermore, most national legal systems acknowledge termination at will regarding contracts concluded for an indefinite period. Termination at will operates then as a technique to enable contracting parties to free themselves from obligations that otherwise would be perpetual. In most cases, notice is to be given to the other party before termination can take effect. Based on principles of good faith and equity, any such termination may not come as a surprise attack upon the other party, and a minimal notice period is to be observed; generally, this notice period is rather short.

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[27] See B. Kohl, Les clauses qui organisent la poursuite des relations contractuelles, *I.B.L.J.*, 2002, pp. 443–460.

[28] See R. Zimmermann & S. Whittaker, *Good Faith in European Contract Law*, Cambridge University Press, 2000, pp. 532–556.

M. Objective Termination Events[29]

Termination clauses frequently provide for termination upon the occurrence of some objective terminating events. In that respect, *insolvency or bankruptcy clauses* are most commonly used. These clauses provide for automatic termination of the contract when one or either party is involved in insolvency, bankruptcy or related proceedings. In this regard, one may note that most national laws do not have a general rule of contract law under which contracts are, by law, terminated upon a debtor's insolvency. Thus, insolvency is, as such, not a general termination ground, and the mere fact of a party's insolvency does not constitute breach of contract.[30] Exceptionally, some specific contracts are under the applicable national law terminated as a result of insolvency.[31] Contract clauses providing for termination upon insolvency are thus needed in those cases when, under national law, insolvency does not, *ipso facto*, terminate the contract and where the contracting parties do not want to continue working with one another in circumstances of insolvency. Insolvency and bankruptcy clauses do have a second function, since they clarify how insolvency is to be defined and state the conditions and procedures for any such termination. As one will see from the examples cited below, these clauses extend their reach from insolvency to payment or attachment problems and, more generally, to these cases where doubts are raised about the financial capabilities of a contracting party to perform under the contract. Mostly, insolvency and bankruptcy clauses tend to formule quite precisely under what circumstances the contract may be terminated:

- "Should any party go into liquidation or be wound up because of inability to pay its debts or compound with its creditors or be placed in the hands of the Receiver, then the other party shall be entitled to terminate this Agreement vis-à-vis the defaulting party with effect from the date of default and without prejudice to the obligation of the defaulting party or its representative to bear its proportionate share of the loss, resulting or to result from the Joint Venture and to any right of action."
- "In the event that either of the Joint Venturers . . .
  "(a) is insolvent or makes a composition or arrangement with its creditors or has a winding up order made or (except for the purposes of amalgamation or reconstruction) a resolution for voluntary winding up is passed or a provisional liquidator receiver or

[29] Under French law, see particularly C. Paulin, *La clause résolutoire*, Paris, L.G.D.J., 1996, 329 pp.

[30] Also, insolvency and bankruptcy clauses may often not qualify as conditions subsequent since the condition is not extraneous to one of the contracting parties.

[31] See the national reports in *I.B.L.J.*, 1997, pp. 837–937.

manager of its business or undertaking is duly appointed or where possession is taken by or on behalf of the holders of any debentures secured by a floating charge on any property comprised in or subject to the floating charge; . . .
then and in any event the other Joint Venturer . . . shall have the following rights . . .
"(i) to terminate the Joint Venture and this Agreement
"(ii) to exclude the Defaulting Party from further participation in the management of the Joint Venture and of the Contract and the profits arising therefrom . . ."

- "If the Contractor is deemed by law unable to pay his debts as they fall due, or enters into voluntary or involuntary bankruptcy, liquidation or dissolution (other than a voluntary liquidation for the purposes of amalgamation or reconstruction), or becomes insolvent, or makes an arrangement with, or assignment in favour of, his creditors, or agrees to carry out the Contract under a committee of inspection of his creditors, or if a receiver, administrator, trustee or liquidator is appointed over any substantial part of his assets, or if, under any law or regulation relating to reorganization, arrangement or readjustment of debts, proceedings are commenced against the Contractor or resolutions passed in connection with dissolution or liquidation or if any steps are taken to enforce any security interest over a substantial part of the assets of the Contractor, or if any act is done or event occurs with respect to the Contractor or his assets which, under any applicable law has a substantially similar effect to any of the foregoing acts or events, or if the Contractor has contravened Sub-Clause 3.1, or has an execution levied on his goods, . . . then the Employer may, after giving 14 days' notice to the Contractor, enter upon the Site and the Works and terminate the employment of the Contractor . . ."[32]

Sometimes, clauses expressly refer the question of interpretation and application to the court or arbitral tribunal having jurisdiction:

". . . In the event that Contractor has reason to believe that the Owner may default for such reasons he may refer the matter to arbitration to make a determination in accordance with the rules of arbitration specified under Clause 66 herein."

Apart from the relatively strict definitions used in the above-mentioned insolvency and bankruptcy clauses, one may also find a more open and

[32] Clause 63.1 (Default of Contractor) of the Conditions of Contract for Works of Civil Engineering Construction—The Red Book, FIDIC, Lausanne, 4th ed., 1989; compare with the much shorter provision of Clause 45.2 of the FIDIC Yellow Book (Conditions of Contract for Electrical and Mechanical Works, 3rd ed., 1988).

judgmental specification in some of these clauses. Such an approach is, however, rare. For an example of that approach:

> "Le contrat passé avec le Sous-traitant pourra être résilié par l'Entrepreneur Principal dans les cas suivants:
>
> . . .
>
> "7—pour décès, cessation ou dissolution d'entreprise, dépôt de bilan, règlement judiciaire même si le sous-traitant était autorisé à poursuivre son activité, liquidation de biens, suspension provisoire des poursuites et plus généralement dans tous les cas où la situation du Sous-traitant se trouve modifiée dans des conditions telles que les garanties techniques ou financières qu'il présente ne sont plus compatibles avec la nature ou l'importance des travaux qui lui sont confiés."

The effects of insolvency and bankruptcy clauses may not only be deduced from the clauses themselves but should carefully be read in conjunction with the applicable law. Some bankruptcy and insolvency laws provide or imply that contracts, which are in force at the date of insolvency, may be continued thereafter by operation of law or by an order of the bankruptcy or insolvency officer or receiver. Given the mandatory character of these rules, the practical impact of insolvency and bankruptcy clauses is dependent on the position taken in the insolvency or bankruptcy jurisdiction regarding the continuation of the contract.[33] One clause illustrates this point:

> "Constitue un Cas de Défaut pour l'une des Parties, ci-après la Partie Défaillante, l'un des évènements suivants:
>
> . . .
>
> 8.1.1.6.
>
> sous réserve du droit applicable à cette procédure, ouverture d'une procédure de liquidation amiable ou d'une procédure collective de règlement du passif; . . ."[34]

Although insolvency and bankruptcy are the major examples of objective terminating events, many other events figure in termination clauses.

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[33] See in this respect, the national reports in *I.B.L.J.*, 1997, 837–937. With respect to France, B. Mercadal, *op. cit.*, pp. 577–581.

[34] Article 8.1. Résiliation en Cas de Défaut, Conditions Générales AFB pour les opérations d'échange de devises et/ou de conditions d'intérêts, Association française des Banques, March 1987.

However, these clauses do not always come into play automatically but often couple the objective event with a termination right. This implies that these events entitle a contracting party to termination but do not oblige him to do so. In that respect, these clauses are much more flexible than insolvency and bankruptcy clauses. These clauses are generally different from other termination clauses, such as those discussed above under Sections IV.G, IV.J and IV.L, since the termination rights are unrelated to conditions subsequent, indefinite term contracts or breach of contract. Unlike many conditions subsequent, they do not work automatically. Also, they do not follow from the indefinite term character of the contract that enables a contracting party to terminate by giving notice. Finally, the terminating events under these clauses (often called Events of Default) are not expressing non-performance due to breach but determine conditions under which the parties no longer want to be bound by their contractual relationship. Characterization of these clauses remains difficult since some of these clauses might be interpreted to express hardship events although in many cases the severe conditions of hardship will not be met. The following example will illustrate:

> "Si les licences d'exportation n'étaient pas obtenues ou si, avant l'achèvement de l'exécution du Contrat, elles étaient retirées par les autorités responsables ou si leur validité était expirée, ou si le certificat du Vendeur confirmant que la licence n'est pas nécessaire se trouve non valable (par suite de l'intervention des autorités responsables du pays du Vendeur), l'Acheteur serait en droit de résilier le contrat en totalité ou en partie."

The practice of extensively enumerating terminating events is particularly frequent in the finance community where they are contained in termination clauses in loans and other credit arrangements.[35] For example:

- "If one or more of the following events of default (each an 'Event of Default') shall occur and be continuing, the Loan Agent and the Banks shall be entitled to the remedies set forth in Section 12.2:

  . . .

  (h) without the prior written consent of the Majority Banks, the Borrower sells or otherwise disposes of all or a substantial part of its assets or ceases or threatens to cease to conduct all or a substantial part of its business as now conducted, or merges or consolidates with any other company unless the purchaser or transferee or the other party to such merger or consolidation is any of the Borrower's Affiliates and is capable of complying with and does comply with all

[35] See also S. Stijns, De beëindiging van de kredietovereenkomst: macht en onmacht van de (kort geding)-rechter/La dénonciation du crédit: les pouvoirs du juge du fond et du juge des référés, *Revue de droit commercial belge*, 1996, pp. 100–167.

the representations, undertakings, covenants and obligations of the Borrower hereunder as if all references in this Agreement to 'the Borrower and any of its Affiliates' were references to 'that Person and any of its Affiliates'; or

(i) without the prior written consent of the Majority Banks, any of the Borrower's Affiliates sells or otherwise disposes of all or a substantial part of its assets or ceases or threatens to cease to conduct all or a substantial part of its business as now conducted, or merges or consolidates with any other company and such sale, disposal, cessation, merger or consolidation might, in the opinion of the Majority Banks, materially and adversely affect the Borrower's ability to perform any of its obligations hereunder unless the purchaser or transferee or the other party to such merger or consolidation is the Borrower or another of its Affiliates; . . .

. . .

(k) A final judgment or order for the payment of money in excess of U.S. $ ______ (or its equivalent in another currency) shall be rendered against the Borrower or any Agency and either (i) enforcement proceedings shall have commenced by any creditor upon such judgment or order or (ii) a stay of enforcement of such judgment or order, by reason of a pending appeal or otherwise, shall not be in effect for any period of 10 consecutive days;

then, . . . , the Bank may . . . declare its obligation to make Advances to be terminated . . ."

N. Partial Termination

Termination clauses generally envisage the complete termination of the contract. In some cases, however, partial termination had been considered and regulated:

- "Si les licences d'exportation n'étaient pas obtenues ou si, avant l'achèvement de l'exécution du Contrat, elles étaient retirées par les autorités responsables ou si leur validité était expirée, ou si le certificat du Vendeur confirmant que la licence n'est pas nécessaire se trouve non valable (par suite de l'intervention des autorités responsables du pays du Vendeur), l'Acheteur serait en droit de résilier le contrat en totalité ou en partie.
  Dans ce cas, le Vendeur remboursera les acomptes correspondant à la partie résiliée du Contrat, avec majoration pour intérêts au taux annuel de x%."
- "Si les deux parties reconnaissent que les défauts, visés au point 14.14, dans certains types de l'équipement ne peuvent être éliminés, ou si, pour les éliminer, il faut plus de 6 mois, l'Acheteur aura le droit de renoncer aux parties correspondantes du Contrat. Dans

ce cas, le Vendeur est obligé de rembourser à l'Acheteur la valeur de l'équipement livré et de payer une pénalité de x% du montant de la partie résiliée du Contrat.
Les conditions du présent point ne constitueront pas un précédent pour les affaires ultérieures."

O. Consequences of the Application of the Termination Clause

Some, but far from all, termination clauses pay attention to the effects of the termination. Basically, two different attitudes have been found regarding the effects of the contract termination on the contracting parties' rights and obligations. In the first approach, all contractual rights and obligations seem to terminate except for those enumerated in the contract. Under the second approach, the contract continues to exist until all differences and disputes have been solved. These are examples of this approach:

- "The Pre-Bid Agreement shall terminate on any of the following occurrences:

  . . .

  But in any event . . . not before:
  —The Bid Bond has been returned,
  —A final settlement of all differences or disputes and all accounts between the Parties has taken place."
- "12.1. This Agreement shall come into force on the date of signature hereof and shall terminate in the event of any one of the following circumstances occurring:

  . . .

  12.1.1. If the Contract has been entered into and has been fully implemented by the Joint Venture Partnership and the Employer when all rights and obligations as well as guarantees and liabilities of the Joint Venture Partnership have ceased and/or have been finally settled with the employer and any Third Party, and all rights and obligations between the Parties in connection with this Agreement have been finalized, and all differences or disputes between the Parties in connection with this Agreement have been finally settled.
  12.2. Upon such termination, the rights of the Parties to make any claims against each other shall cease forthwith."
- "L'Association créée ce jour entrera en vigueur avec la signature de tous les Associés. Elle durera jusqu'à ce que:

  . . .

  2) La soumission soit acceptée; alors l'Association prendra fin au plus tard avec l'apurement définitif de tous les comptes qui seraient la conséquence directe ou indirecte de son objet, tant avec le Maître d'Ouvrage qu'avec les tiers ou entre Associés.

Même après cette date, les Associés resteront liés jusqu'à l'extinction de toutes les obligations légales et contractuelles résultant du marché ou des marchés qui auront été conclus, à moins qu'il n'en soit autrement convenu d'un commun accord lors de la dissolution de la Joint Venture."[36]

Sometimes, the life of the contract may, by operation of these clauses, be prolonged for a considerable period as in the following example:

". . . Sub-Contractor shall remain bound by the present Sub-Contract during the period of time covered by the duration of the guarantees imposed upon Sub-Contractor by the present Sub-Contract, and by the clauses of the Main Contract applicable to its deliveries and Works."

Termination clauses also often provide for the remedies that follow upon termination:

- "La Partie lésée pourra en outre demander à la Partie dont le comportement a entraîné la résiliation anticipée du Contrat des dommages et intérêts en réparation du préjudice qu'a pu lui causer la caducité du Contrat."
- ". . . Dans le cas où après l'expiration de ce délai les défauts ne seraient pas éliminés, l'Acheteur a le droit de renoncer à l'équipement défectueux et de demander de le remplacer par un équipement de bonne qualité ou résilier le Contrat dans sa partie concernant l'équipement défectueux."
- "The terminated party shall bear all the costs arising out of or in connection with termination."

Sometimes, detailed termination procedures have been provided for as in this case:

- "The Engineer shall, as soon as possible after such termination, certify the value of the Works and all sums then due to the Contractor as at the date of termination in accordance with Clause 33. The Employer shall not be liable to make any further payments to the Contractor until the Works have been completed. When the Works are so complete, the Employer shall be entitled to recover from the Contractor the extra costs, if any, of completing the Works after allowing for any sum due to the Contractor under Sub-

[36] In this case, the contractual provision treats both the effect of termination on the parties' rights and obligations and the way the contract termination is to be effected (*apurement de tous les comptes*). The termination clause should ideally distinguish more clearly between these two elements.

Clause 45.3. If there is no such extra cost the Employer shall pay any balance due to the Contractor."[37]

- "In the event of such termination the Employer shall pay the Contractor an amount calculated in accordance with Sub-Clause 44.8.[38] The Employer shall pay in addition the amount of any loss or damage, including loss of profit which the Contractor may have suffered in consequence of termination. The additional amount shall, however, not exceed the limit specified in the Preamble."[39]
- ". . . the Contractor shall allow or pay to the Employer in the manner hereinafter appearing the amount of any direct loss and/or

[37] Clause 45.3 (Valuation at Date of Termination) and 45.4 (Payment after Termination) of the FIDIC Yellow Book (Conditions of Contract for Electrical and Mechanical Works, 3rd ed., 1987); see also clause 63.2 and 63.3 of the Conditions of Contract for Works of Civil Engineering Construction—The Red Book, FIDIC, Lausanne, 4th ed., 1989.

[38] This clause relating to payment on termination due to *force majeure* provides as follows:

> "If the Contract is terminated under Sub-Clause 44.7 the contractor shall be paid the value of the work done.
>
> The Contractor shall also be entitled to receive:
>
> (a) the amounts payable in respect of any preliminary items so far as the work or service comprised therein has been carried out and a proper proportion of any such item in which the work or service comprised has only been partially carried out,
>
> (b) the cost of materials or goods ordered for the Works or for use in connection with the Works which have been delivered to the Contractor or of which the Contractor is legally liable to accept delivery. Such materials or goods shall become the property of and be at the risk of the Employer when paid for by the Employer and the Contract shall place the same at the Employer's disposal,
>
> (c) the amount of any other expenditure which in the circumstances was reasonably incurred by the Contractor in the expectation of completing the whole of the Works,
>
> (d) the reasonable cost of removal of Contractor's Equipment from the Site and the return thereof to the Contractor's works in his country or to any other destination at no greater cost, and
>
> (e) the reasonable cost of repatriation of the Contractor's staff and workmen employed wholly in connection with the Works at the date of such termination."

[39] Clause 46.3 (Payment on Termination for Employer's Default) of the FIDIC Yellow Book (Conditions of Contract for Electrical and Mechanical Works, 3rd ed., 1987); see also clause 69.3 (Payment of Termination) of the Conditions of Contract for Works of Civil Engineering Construction—The Red Book, FIDIC, Lausanne, 4th ed., 1989.

damage caused to the Employer by the termination. Until after completion of the Works under clause 27.3.2 the Employer shall not be bound by any provision of this Contract to make any further payment to the Contractor but upon such completion and the verification within a reasonable time of the accounts therefor the Employer shall state the amount of expenses properly incurred by the Employer and the amount of any direct loss and/or damage caused to the Employer by the termination and, if such amounts when added to the monies paid to the Contractor before the date of termination exceed the total amount which would have been payable on due completion in accordance with this Contract, the difference shall be a debt payable to the Employer by the Contractor, and if the said amounts when added to the said monies be less than the said total amount, the difference shall be a debt payable by the Employer to the Contractor."

These clauses set forth the manner in which the termination of the contract is to be implemented and the way compensation for termination is determined. Various methods have been developed. One method is the *lump-sum* method, which determines, in advance, the damages to be paid. This method has been analyzed in another chapter to which reference is made.[40] In some cases, a ceiling is put on the liability of a contracting party under the termination clause by means of an overall liquidation and penal damages clause:

"Notwithstanding anything to the contrary in the Conditions the total financial liability of the Contractor under clause 27 shall, including any liability for liquidated and ascertained damages, be limited to an amount equivalent to 10% of the original Contract Price and the Owner shall indemnify the Contractor against any expense, liability, loss, claim or proceedings whatsoever in excess of the said limitation of liability."

Other methods, such as those cited earlier, refer to the contract value to determine the amount of damages or compensation. Various options are open. The termination clause may consider including or excluding compensation for loss of profit, indirect damages, termination charges paid to sub-contractors and the value of residual assets. It is advisable that the various elements of the compensation to be paid be clearly identified in the contract. An example of a clause where some items of the compensation are specified follows:

- "A Defaulting Party shall, on demand, indemnify and hold harmless the Designating Party for and against all reasonable out-of-

[40] See *supra*, Chapter 7.

pocket expenses, including attorney's fees, incurred by the Designating Party by reason of the enforcement and protection of its rights under this Master Agreement or any Rate Protection Agreement, including, but not limited to, costs of collection."

- "If the cause of termination is the default of either party hereto the other party shall be entitled in addition to be paid its reasonable costs and expenses connected with or arising from the termination not included in the Account submitted under sub-Clause (A) above and any additional damages to which such other party may be entitled at law. The parties hereto shall within 6 (six) months of the date of termination agree the amounts payable under this sub-Clause and shall record their agreement by exchange of letters. Failing agreement within such period the matter in dispute shall be referred to Arbitration in accordance with Clause 24 hereof."

Sometimes, the assessment or calculation of the compensation is left to one of the parties:

> "The parties further agree that a statement in reasonable detail by the Designating Party in good faith showing the calculation of the foregoing amounts shall be conclusive in the absence of manifest error."

In complex cases, the procedure to determine compensation will have to involve auditors or other specialists. It is advisable that the appointment of these specialist, their mandate, the payment of their fees and the nature of their opinions is clearly settled in the contract. The specialist may be appointed by one party as in this case:

> "The actual costs referred to under a. of article 17.3 shall be examined and certified as sound by external auditors appointed by COMPANY. All costs involved therein shall come to CONTRACTOR's account."

Sometimes, the contract provides for the identity of the nominated expert and his mandate as in the following sample:

> "In the event of complete or partial termination of this Agreement for any reason whatsoever, the Corporation shall . . . submit an account in writing . . .
>
> The said Account shall be accompanied by a Report from . . . Chartered Accountants who acting as Experts shall report whether or not in their expert opinion the Account has been properly prepared in accordance with this Clause whereupon such Account

and Report shall be conclusive and binding upon . . . and the Corporation."[41]

In their provisions regarding the effects of termination, much attention is paid to the remedies available to the aggrieved party. However, the obligations of that party under those circumstances is barely addressed. In one clause, mention was made of this party's obligation to mitigate the other party's losses:

"The Non-Defaulting Party shall be entitled to:

. . .

(ii) make or attempt to make arrangements to avoid, mitigate or reduce the losses which would, or which, in the opinion of the Non-Defaulting Party, might, otherwise arise from such termination; . . ."

In some cases, it is expressly and cautiously stated that the remedies enumerated in the contract do not exclude any other remedies that may be available under the applicable law:

". . . the other Joint Venturer (hereafter called "the Continuing Party") shall have the following rights (without prejudice to any other rights and remedies of the Continuing Party against the Defaulting Party under common law statute or otherwise) . . ."

At the other side of the spectrum, the termination clause may provide for an exemption clause such as the following:

"Dans aucune des circonstances ci-avant, le Franchisé n'aura aucun droit à réclamer des dommages et intérêts du chef de la résiliation intervenue du Contrat."[42]

In practice, there may be important questions as to how to solve disputes between the contracting parties in the period between the moment that it becomes clear that termination will follow and the moment that national courts or arbitral tribunals may rule on the substance of the claims of either party in relation to such termination. Absent contractual provisions, the par-

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[41] The interpretation of this termination clause has been the subject of an ICC arbitral procedure where the arbitral tribunal in a partial final award has held that termination accounts that were not prepared by an expert appointed by both parties in accordance with the contractual clause, were not binding (Case 7071, Partial Final Award dated January 28, 1996, unpublished).

[42] See *supra*, Chapter 7.

ties will have to seek amicable solutions to these interim problems or will have to seek provisional measures before national courts or arbitrators. Some contractual provisions deal to a certain extent with these issues:

- ". . . the Employer may, after having given 7 days notice to the Contractor, terminate the Contract and expel the Contractor from the Site.

  . . .

  The Employer may upon such termination complete the Works himself or by any other contractor."[13]
- "The Contractor shall be entitled to remove immediately all Contractor's Equipment which is on the Site."[44]
- ". . . Contractor shall immediately or upon such other date as is specified in the notification discontinue its performance of WORK, or the relevant part thereof, and shall assign to COMPANY, or its nominee, all rights and titles referred to in article 4.4 . . ."

The examples just given reflect the fact that the contracting parties, in their contracts, insert provisions containing obligations that survive the contract or that come into play at the termination of their contractual bonds. The former clauses have already been analyzed in a different chapter and relate, *inter alia*, to issues such as inventory and stock available at termination, return of documents, removal of equipment, buildings or advertisement boards or client orders coming in after termination.[15] It is obvious from those analyses, and from many examples in this section, that the concept of termination itself is, in this regard, often ambiguous and that the termination clause either expressly or impliedly does not exclude that certain provisions (the applicable law clause, the dispute resolution clause, confidentiality clauses and clauses in restraint of trade) continue to be in effect despite the so-called termination of the contract. Further reference is made to the analyses in the following chapter. As to clauses intended to become operational upon termination, the following may be cited:

- "The Employer may employ and pay other persons to carry out and complete the design and construction of the Works and he or they may enter upon the Works and use all temporary buildings,

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[13] Article 45.2 (Contractor's Default) of the FIDIC Yellow Book (Conditions of Contract for Electrical and Mechanical Works, 3rd ed., 1987); compare with clause 63.1 of the Conditions of Contract for Works of Civil Engineering Construction—The Red Book, FIDIC, Lausanne, 4th ed., 1989.

[44] Article 46.2 (Removal of Contractor's Equipment) of the FIDIC Yellow Book (Conditions of Contract for Electrical and Mechanical Works, 3rd ed., 1987); see also clause 69.2 of the Conditions of Contract for Works of Civil Engineering Construction—The Red Book, FIDIC, Lausanne, 4th ed., 1989.

[15] See *infra*, Chapter 13.

plant, tolls, equipment, goods and materials intended for, delivered to and placed on or adjacent to the Works, and may purchase all materials and goods necessary for the carrying out and completion of the Works."

- ". . . the Contractor shall if so required by the Employer within 14 days of the date of termination, assign to the Employer without payment the benefit of any agreement for the supply of materials or goods and/or for the execution of any work for the purposes of this Contract but on the terms that a supplier or sub-contractor shall be entitled to make any reasonable objection to any further assignment thereof by the Employer."
- ". . . the Employer may pay any supplier or sub-contractor for any materials or goods delivered or works executed for the purposes of this Contract (whether before or after the date of termination) in so far as the price thereof has not already been paid by the Contractor."

V. CONCLUSIONS

As has become tradition, reports prepared by the Working Group end with some advice and suggestions to contract draftsmen. Naturally, it is recommended to be precise and accurate and to avoid ambiguity and repetition. Also, a well-drafted termination clause (at least as much as any other clause) is defective without an adequate choice of law clause and consideration of procedures to resolve disputes.

In themselves, termination clauses vary so much according to the contractual context that we refrain from making more specific recommendations for general application. Hopefully, readers will benefit from the obvious defects of some of the clauses we have quoted and from their enormous variety.

CHAPTER 13

POST-CONTRACTUAL OBLIGATIONS IN INTERNATIONAL CONTRACTS

I. INTRODUCTION

The classical theory of obligations places the contract in a clearly defined time period. A contract is made when the offer is accepted. It normally ends with the performance of the parties' obligations or on expiry of the term provided. It may end prematurely as a result of a specific incident, such as in a case of *force majeure*, the remission of a debt or termination due to non-performance.

Upon examination, it becomes clear that, in practice, the temporal limits of contracts, especially international contracts, are often much less precise.

From the above chapter on letters of intent,[1] it emerged that "upstream," the demarcation between the period preceding the contract and the time the contract was made often proved difficult to establish. The negotiation period, far from being a vacuum from a legal point of view, is, in fact, a period full of expressions of will. Commitments are made to organize the negotiation. The contract itself is made progressively, by successive, more and more detailed agreements. Sometimes, the parties even decide to start performing the agreement before it has been entirely concluded.

What is the situation "downstream"? It appears that quite often the contract does not terminate in a clear-cut way either. Although essentially the parties' obligations have been performed, the contract will not resign itself to die. It survives in a series of undertakings with which one or the other party continues to comply.[2]

These undertakings are of different types. Some arise out of past events. The situation, which the contract created between the parties, must be wound up: documents must be returned, necessary action taken with regard to stock, outstanding orders need to be dealt with, etc. Others, more characteristically, provide for a veritable extension into the future of con-

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[1] See *supra*, Chapter 1.

[2] This concept of contract law can be associated with the theory of relational contracts, referred to elsewhere in this volume (see *supra*, pp. 212–213 and *infra*, pp. 625–628).

tractual relations, whether this involves maintaining in force certain obligations (for example a confidentiality clause or the obligation not to compete), or the creation of new obligations (for example a loyalty commitment as to the conclusion of future contracts).

We shall attempt to provide a general overview, illustrated by clauses taken from the sample gathered and discussed by the Group (Section II), before setting out a few thoughts on the specific legal problems which may arise from these post-contractual clauses (Section III).

One *caveat* should, however, be entered first. The expression *post-contractual* obligations is not, strictly speaking, correct. Rather, it is the contract itself that survives through these obligations. It is quite clear that the obligations in question also arise from the contract, by virtue of express stipulations, or even implicitly, and especially based on the principle that agreements are to be performed in good faith.[3]

The expression post-contractual obligations has the merit, however, of emphasizing the fact that, essentially, the contract has been performed. The parties' principal obligations have been performed (or have ceased to exist for another reason). The goods sold, for example, have been delivered and the purchase price paid. However, the seller is still bound by his guarantee against latent defects. The agency contract is finished after having been properly performed, but the agent is still bound by the obligation not to compete.

Here is an example of the terminology used in practice:

> "Termination of this agreement for whatever reason shall not . . . affect or prejudice the rights and obligations of the parties pursuant to articles 5.1, 5.2, 9.8, 10.4, 10.6, 11.9 and 15.6, which are continuing in nature and shall survive termination."

II. POST-CONTRACTUAL OBLIGATIONS: GENERAL OVERVIEW

The sample of post-contractual clauses gathered by the Working Group is large (several dozens of clauses) as well as diversified. We shall attempt to create an overview and to propose a certain classification, illustrating each case. These examples are clearly not exhaustive, since there is a great variety of post-contractual obligations. However, the obligations described below seemed to us to occur particularly frequently and to be eminently characteristic.

The aim of the present chapter is to attempt to arrive at an overview of the problems common to post-contractual obligations. We will therefore

[3] On this point, see *infra*, pp. 612–614.

not dwell on each type of clause, whatever its specific interest. We could devote whole reports to confidentiality clauses, to undertakings not to compete or to clauses that govern what is to be done with stock remaining at the end of a contract, but that is not the purpose of this study.[4] The reader must therefore excuse the cursory way in which each individual clause is treated. The objective here is to offer a few thoughts of a global nature on this assortment of clauses.

The clauses are classified into two principal categories, those that merely organize the winding up of the past, and those that make arrangements for an extension of the contract into the future.

A. Winding Up of the Past

In the first series of examples, the obligations in question are designed merely to wind up the situation that the contract had created.

The concept of "winding up" is borrowed from company law. During its existence, a company engenders a set of complex relationships that do not automatically disappear when the company is dissolved. It is necessary to arrange its final settlement. That problem does not arise generally in relation to contracts that are performed instantaneously, where everything is accomplished when the parties have each provided performance; each party takes away what it has received from the other, and that is the end of the matter.[5] The situation is different for long-term contracts, that are very frequent in international trade. Such contracts create and prolong between the parties a relationship of collaboration which confers very clear company law aspects upon them. When they have terminated, such contracts often leave behind a situation which must be wound up.

1. Fate of Remaining Stock

At the expiry of a distribution contract, one party may find itself in possession of stocks of the product. What is to be done with them?

It is sometimes stipulated that the producer reserves the right to buy back this stock:

> "Upon termination of this agreement by expiration or otherwise . . . X shall have the right, as its option, to notify distributor within thirty days after the effective date of such termination that it will

[4] Confidentiality clauses are analyzed as such in Chapter 5.

[5] Problems of winding up arise nonetheless, even in contracts with instantaneous performance, when the agreement is to be annulled or terminated, given the retroactive effect of these mechanisms under certain legal systems.

repurchase the entire inventory, or any part thereof, of the products then in possession or under the control of distributor. . . . Distributor shall make available for collection by X within thirty days after the giving of such notice the products specified in such notice and X shall pay distributor the net price previously paid by distributor to X for such products."

The following clause, which obliges the producer to re-purchase the stock, is more favorable to the distributor:

"In the event of cancellation or termination of this agreement, the Company shall purchase or cause to be purchased all unsold stocks or Company products from the distributor and representative at the delivered costs to the distributor and representative at its warehouse."

Another solution is to allow the distributor to continue to sell the stocks himself for a fixed period, any remaining stock then being bought back by the manufacturer:

"Upon termination of this agreement, X shall have a period of ninety (90) days from the effective date of termination to attempt to sell within the territory any equipment (including spare and replacement parts and accessories) in its stock or possession. At the expiration of such ninety (90) days period, Y agrees to repurchase from X X's remaining stock of equipment (including spare and replacement parts and accessories purchased from Y) in good condition and at X's actual cost therefor (works, Y factory)."

2. *Fate of a Data Bank*

A publisher makes a data bank available to a user, who registers the data. How is one to organize the fate of such data after termination of the contract by the publisher? The following clause gives an example of a possible arrangement:

"En cas de résiliation du contrat par l'éditeur, X pourra continuer à exploiter les données enregistrées moyennant le paiement, durant une période de cinq ans, de l'indemnité de consultation prévue à l'article 5. Passé ce délai, X pourra poursuivre la diffusion des données dont il disposait au moment de la résiliation, sans être redevable envers l'éditeur de l'indemnité de consultation précitée."

3. *Return of Documents*

For the performance of a contract for the transfer of technology, the seller may have provided the buyer with various documents: plans, guides, manuals etc. Their return is often provided for at the end of the contract:

> ". . . B shall upon termination of this agreement cease to have the aforementioned rights in the . . . technology and shall be obliged to return all manual documents and drawings supplied by A hereunder and all copies thereof."

The following clause also provides for the return of various documents, which were provided, in this case, in the context of a distribution agreement:

> "In case of this agreement being terminated, X shall immediately (but subject to article 14(4) and at its expense) return to Y or hand over to its duly authorised representative all technical informative material and other sales promotional material, such as a pricebooks, that have been supplied by Y. X shall have no obligation at any time to hand over or reveal to Y its correspondence with customers or customer lists."

Here is a standard clause drawn up by Organisme de Liaison des Industries Métallliques Européennes (Orgalime):

> "Les documents et matériels dont la liste figure dans les annexes I et II sont, de convention expresse, considérés comme restant la propriété du Concédant. A l'expiration du Contrat, le Licencié devra restituer tous les plans, documents et outillages reçus dans l'état où ils se trouveront et sans en garder de reproduction."[6]

4. *Return of Advertising Materials*

A distributor is often entrusted with advertising materials relating to the product that forms the subject matter of the contract. Their return (or sometimes their destruction) may be stipulated:

- "Distributor covenants and agrees that it will, at its own cost, remove immediately from its place of business, and destroy or surrender to X all signs, boxes and advertising materials which make any mention of or reference to . . . or any of the . . . or specifically by name any of the products."

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[6] Orgalime, *Model International Contract for the transfer of technology*, EU/EEA version, June, 1997 and *International Technology License Agreement Outside UE/EEA*, September 1999, Art. 28.3—Variant B.

- "A la fin du contrat,le concessionnaire est tenu de restituer au fabricant tous les moyens de publicité et autres documents visés au chapitre III article 13, mis à sa disposition et qui se trouvent en sa possession."

5. *Effects of Outstanding Orders*

When a distribution agreement ends, what will be the effect of orders transmitted by the distributor before the expiry of the agreement?

The first problem is establishing whether these orders are to be filled. In this connection, here is a very radical clause:

> "Upon termination X shall have no obligation to deliver, and distributor shall have no obligation to accept any products which are the subject of unfulfilled orders of distributor accepted by X before such termination."

The other option is more common:

> "The company further agrees to fulfil any orders placed on the distributor and representative and remaining outstanding at the date when cancellation or termination becomes effective and will indemnify the distributor and representative in respect of any claims arising out of a failure to fulfil such orders."

Another problem relating to orders still outstanding at the rupture of the contract is that of the agent's right to commission payments once those orders are fulfilled. The two following clauses cover that delicate question:

- "Les commandes qui auront été transmises par l'Agent avant l'expiration du contrat et qui aboutiront à la conclusion d'une vente au plus tard . . . semaines/mois après cette date ouvriront droit à la commission prévue à l'article 18."[7]
- "Toutes les affaires en cours, mais non encore conclues à la date d'effet de la résiliation du lien contractuel ayant fait l'objet d'une remise d'offre antérieure, donneront droit au profit du représentant, dans les conditions de l'article 5.6 ci-dessus et dans les limites de l'offre remise, à une commission égale à 50% de son taux normal, à condition que la commande correspondante soit définitivement acquise à l'entreprise dans les six mois de la date d'effet de la résiliation du lien contractuel."

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[7] Orgalime, *Agency Contract—International Agency on an Exclusive Basis*, February 1990, reprint with amendments, June 1999, Art. 31 A.

6. *Risk of "Posteriority" and Insurance*

In liability insurance where the trigger event (in general, fault on the part of the insured) and the claim of the injured third party may be separated by a greater or lesser time lapse, certain policies may extend cover beyond their term, to include subsequent claims, as long as they are the consequence of trigger events that occurred during the currency of the contract. Here is an example, taken from an insurance policy designed for lawyers' professional civil liability cover:

> "Article 5. La garantie s'applique aux réclamations formulées, même après l'expiration du contrat, sur base des faits générateurs de responsibilité survenus pendant la période de validité de la police. Pour autant que de besoin, il est precisé que la garantie passe aux héritiers et ayants droit."

The risk of "posteriority" is a matter that has caused considerable legal developments in certain countries, such as France,[8] Belgium[9] and Spain.[10] In certain sectors, where claims may appear many years after the trigger event (e.g., medical, pharmaceutical or environmental liabilities), insurers attempt to exclude coverage of such post-contractual claims, with so-called "claims-made clauses":

> "La garantie est limitée aux réclamations introduites pendant la durée du contrat, résultant de faits générateurs survenus pendant la même période."

Claims-made clauses intend to discharge insurers from all post-contractual liabilities. In the countries mentioned above, they have been condemned or restricted by courts or legislation.

7. *Effects on Work in Progress*

When a contract for construction terminates prematurely, the fate of the works in progress must be settled. The problem is extremely vast, with regard to, *inter alia*, the applicable law and the reason for the termination of the contract (breach on the part of the construction company, *force majeure*, unilateral decision of the prime contractor, etc.). Here is an example of a contractual provision governing that problem, in a sub-contract:

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[8] Cf. G. Viney, La clause dite de "réclamation de la victime" en assurances de responsabilités, *Jur. Class. Pér.*, 1994, Doctr., No. 3778.

[9] Cf. M. Fontaine, *Droit des assurances*, 2nd ed., 1996, pp. 303–309.

[10] Cf. A. Martinez Alvarez-Baron, Spain's Claims-Made Crisis, *Int. J. of Ins. Law.*, 1994, pp. 316–319.

"Contractor may, at its option, terminate sub-contract at any time in whole or in part by written notice thereof to sub-contractor whether or not sub-contractor is in default and whether or not main contract is subject to termination. Upon receipt of any such notice, sub-contractor shall, unless the notice directs otherwise, immediately discontinue works on the date and to the extent specified in the notice; place no further orders or sub-contracts for materials, equipment, services or facilities except as may be necessary for completion of such portion of the work as is not discontinued; promptly make every reasonable effort to proceed with cancellation upon terms satisfactory to contractor of all orders, sub-contracts and rental agreements to the extent they relate to the performance of work discontinued and shall thereafter do only such work as may be necessary to preserve and protect work already in progress and to protect materials, plant and equipment at the project site or in transit thereto."

The fate of work in progress is clearly not the only question to be settled in the case of premature termination of a construction contract. Other clauses frequently cover the fate of remuneration owed to the construction company, and the problem of compensation that one or the other of the parties may be liable to pay.

B. Extension Into the Future

The first group of clauses discussed above, covering situations where the contract has been wound up, survive it insofar as they continue to apply once the contract has come to an end. However they do not, strictly speaking, extend the contract. They lay down the final settlement of relations between the parties to achieve, as quickly as possible, a situation in which they are no longer bound to each other.

Other clauses purport to maintain certain contractual obligations into the future. The aim here is, in fact, an arrangement ensuring the lasting survival of certain legally binding links after the principal obligations have come to an end. Sometimes the obligations in question existed already and are extended into the future; in other cases, on the contrary, the obligations are new ones that only begin to go into effect when, essentially, the contract has ended.

As mentioned, the objective here is not to examine each clause in itself, but to present as broad a selection as possible of the various post-contractual clauses, in order to ascertain what problems they share.

1. Agreements Not to Compete

Many contracts impose, on one or the other party, a covenant to restrain from various forms of competition with the other party.

Thus, in the case of a *sale of an undertaking* or *of the goodwill of a business*, the seller generally undertakes not to compete with his buyer. The obligation is stipulated for a specified duration. It therefore survives the sales contract that was performed immediately upon delivery and payment of the purchase price. Here is an illustration:

> "Le vendeur s'interdit le droit de tenir, créer, s'intéresser directement ou indirectement, à un fonds de commerce de même nature que celui vendu ce jour, en Europe, à peine de dommages et intérêts envers l'acheteur et ce, pendant une durée de cinq ans."

A contract for *the sale of goods*, on the other hand, would not normally require the inclusion of a covenant in restraint of competition on the part of the seller. The Group found an example of one, however, in a case where the product sold had been manufactured by the seller in accordance with the buyer's specifications:

> "The seller undertakes that, for a period of five (5) years from and after the date of this agreement, he will not engage in any manner in a business competitive with the . . . business."

In a *contract for the transfer of technology*, the supplier often undertakes, for the duration of the contract, not to compete himself with the transferee; it is rare for such a commitment to survive the contract. As regards the assignee, the expiry of the contract normally terminates the authorization to use the process, which is confirmed in the following clause, expressing a post-contractual obligation not to do so:

> "A l'expiration anticipée, normale ou prorogée du présent contrat, le preneur s'interdit de continuer à faire usage du processus technologique communiqué ou de laisser continuer cette activité par des tiers."[11]

But the opposite solution may be stipulated:

> "Le Licencié pourra, à l'expiration du Contrat, continuer à fabriquer les Produits Licenciés et à utiliser la Technologie Licenciée

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[11] Clause cited by J.M. Deleuze, *Le contrat international de transfert de technologie*, Paris, 4th ed., 1988, p. 198.

portée à sa connaissance par le Concédant, sans avoir à payer d'autres redevances."[12]

Distribution agreements are a favorite field for covenants in restraint of competition. The intermediary often undertakes not to compete for the duration of the contract itself, but that obligation often extends beyond the term:

"The representative agrees that he will not directly or indirectly represent for the purpose of sales or solicitation of sales or for any other purpose a concern which makes or sells equipment or products similar to that produced by the company and that he will not in any manner compete directly or indirectly with the company unless special written consent has been given by the company, and that he will not solicit orders or take orders for a competitor of the company for a period of ninety (90) days following the termination or cancellation of this contract, and that for a period of ninety (90) days following the termination or cancellation of this contract he shall refrain from competing with the company or offering sales leads to other manufacturers, sales representatives or sales agencies of similar equipment and products of the company on any active sales prospect under way at the time of the representative's departure from employment as a representative of the company."

2. Duties of Confidentiality

For the performance of, or during the performance of, many different types of contract (contracts of employment, distribution agreements, subcontracts, research contracts, contracts for the transfer of technology, etc.), confidential information is shared by the parties. The contracting party, which originally held that information, is often careful to prohibit the other party from divulging the information to third parties. Such a duty, which is originally provided for during the currency of the contract, is almost always expressly extended in time.

Here are four examples that have been taken from various contracts:

A contract of employment:

"The executive shall not, either during the continuance of his employment hereunder, except as required in the performance of his duties, or after termination thereof, for whatever reason, disclose, publish or communicate to any person, firm or corporation:

[12] Orgalime, *Model International Contract for the transfer of technology*, EU/EEA version, June, 1997 and *International technology license agreement outside UE/EEA*, September, 1999, Art. 28.3—Variant A.

"(i) any trade or business secrets or confidential information of the company or the affiliate or their clients, or of any affiliate of the company or their respective personnel;

"(ii) any information received or obtained in relation to the affairs of the company or the affiliate or their clients, or of any affiliate of the company, or their respective personnel;

"(iii) the working of any process or invention which is now or may in the future be carried on or used by the company or the affiliate or the clients, or any affiliate of the company or which the executive may make or discover why employed hereunder."

A sub-contract:

"10. Sub-contractor's confidentiality

"Sub-contractor agrees that he shall not, without the priory written consent of contractor, disclose or make available to any person, other than contractor, or use, directly or indirectly, except for the performance and implementation of the sub-contract, any information acquired from contractor or its subsidiaries or affiliate, or from any other source in connection with the performance of the sub-contract . . . The obligations contained in this Article shall continue notwithstanding the completion of the Project or termination of the Sub-contract."

A sales contract:

"Dans la mesure où l'acheteur et le vendeur, au cours de la réalisation du contrat, ont connaissance de résultats technico-scientifiques, de secrets d'enterprise, de prix, de procédés de production, de brevets, entre autres, des entreprises concernées de la partie adverse ou si des documentations techniques leur sont remises par ces entreprises, ils sont alors tenus au secret. Ceci est également valable après la résiliation du contrat."

A research contract:

"Les parties s'engagent à garder strictement confidentielles toutes les informations communiquées par l'autre partie et tous les résultats obtenus du travail de collaboration de ce contrat.

"Cet engagement de secret ne s'applique pas à:

"1—ce qui est déja en possession de chaque partie au moment de l'accord;

"2—ce qui est maintenant de connaissance publique ou qui devient ensuite de connaissance publique à travers les voies d'information ordinaires.

"La clause de discrétion survit pendant cinq années à l'échéance de ce contrat."

It should be pointed out that the fourth example is the only one to fix a time limit for the duty of confidentiality.

Confidentiality undertakings are specifically examined in another chapter of this book.[13]

3. Guarantee Obligations

Guarantee obligations owed by certain contracting parties may often be classified as post-contractual obligations. Their effects are felt after the essential obligations have been performed, for example, after delivery of the goods by the vendor or after the builder has finished the construction work.

Such obligations are, in general, governed by the applicable law itself, and the contractual clauses relating to them are usually designed to modify normal legal solutions in order to render them more or less stringent, or in some cases, better adapted to the objectives sought by the contracting parties.

Examples are extremely numerous and well known. We will merely cite some particularly interesting clauses.

The following is an example showing how a guarantee obligation on the part of the vendor or the builder is often coupled with a commitment to stock spare parts for a sufficiently long period of time, and, in some circumstances, even skilled staff:

- "Unless the principal shall have made reasonable alternative arrangements for supply of spare parts to customers the principal shall for a period of ten years after notice of termination use all reasonable means to supply all orders from the distributor for spare parts up to quantities needed for the products sold by the distributor prior to the termination of this agreement provided that if this agreement is terminated in accordance with sub-clauses (ii), (iii) or (iv) of clause 7 (a) the principal shall not be obliged to supply such spare parts to the distributor but may supply them directly to such persons as may be in possession of the products."

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[13] See *supra*, Chapter 5.

- "Al final del periodo de garantía, X se compromete con relación a Y a mantener en México personal capacitado durante los diez años siguientes para corregir los defectos del equipo que Y no pudiera corregir. Los gastos correspondientes se facturaran en las condiciones vigentes a esa fecha.
  "Durante un lapso de diez a_os X se compromete a conservar disponibles ya sea las refacciones originales o sus equivalentes para cubrir las necesidades de mantenimiento de Y y/o su cliente."
- "Seller shall assign one (1) qualified service representative at buyer's main base of operation or other location as buyer may direct. Such assignment shall commence approximately one (1) month prior to the month specified in this agreement for delivery of buyer's first aircraft hereunder and continue for its least one (1) year after the delivery of buyer's last aircraft hereunder."

Certain contracts require the guarantor to take out appropriate insurance to cover what he has undertaken to do:

> "La société étant également responsable de la sécurité des constructions, s'engage à contracter les assurances nécessaires couvrant sa responsibilité à l'égard du client pendant 10 ans à partir de la réception provisoire des bâtiments."

A guarantee against legal problems is frequently inserted into certain contracts, especially in case of intellectual property disputes. The object is often to assign the cost of legal defense proceedings to one or another of the parties:

> "16.1 Le preneur de commande déclare qu'il n'a aucun droit de propriété industrielle faisant obstacle à l'exploitation du four conformément aux termes de ce contrat, et en particulier, qu'aucun droit de tiers ne peut entraver la vente mondiale des produits fabriqués par l'installation.
>
> "16.2 Si endéans un délai de 10 ans après la reception du four, il se révèle qu'une violation de ce droit existe, le preneur de commande est obligé d'entreprendre immédiatement, à ses propres frais et après accord préalable de . . . , les dispositions pour remplir son obligation aux termes du §16.1."

An agreement between shareholders provides for different settlements. It is based on various representations and warranties that have been given. The following clause causes such representations and warranties to survive performance of the agreement:

> "The Shareholders agree that all representations and warranties contained in this Agreement . . . shall survive the execution and delivery of this Agreement and the consummation of the transactions contemplated hereby, regardless of any investigation made by the Shareholders or their independent accountants or legal representatives:
>
> "(i) with the exception of the representations and warranties set forth in SECTION 7.2(a)(i), for a period of three (3) years following the day of Execution;
>
> "(ii) with respect to the representations and warranties set forth in SECTION 7.2(a)(ii), for a period of ten (10) years following the day of Execution;
>
> . . ."

4. *Communication of Improvements and Refinements*

Contracts for the transfer of technology sometimes permit the buyer to continue to use information transmitted after the contract has expired. We gave an earlier illustration of this.[14] But the parties sometimes stipulate a post-contractual obligation to communicate to each other improvements and refinements that they develop during the exploitation of the process:

> "Les parties se communiquent réciproquement à titre informatif et gratuit, pendant une période de 5 ans à partir de la réception de l'installation objet du présent contrat, toutes les innovations, améliorations, perfectionnements et informations techniques supplémentaires qui seront en leur possession et dont elles ont la libre disposition concernant le fonctionnement et l'exploitation de l'installation objet du présent contrat, ainsi que le procédé de fabrication utilisé."

5. *Fidelity, Exclusivity, First Refusal*

The extinction of the contract marks the end of a period of collaboration between the parties. It is sometimes stipulated that if, in the future, one of the contracting parties should come to make a new agreement of this type, that party should do so with the original contracting party, or, at the very least, give that party first refusal.

Here are two examples that have already been quoted in a previous chapter:[15]

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[14] See *supra*, p. 605–606.

[15] See *supra*, Chapter 10.

- "Dans tous les cas où B exportera du pays X vers le pays Z, des véhicules B et/ou des pièces de véhicules B fabriquées par B, en vertu des présentes, B . . . devra proposer d'abord la vente des véhicules B et des pièces de véhicules B à la firme C ou telle autre société qui aurait le droit d'agir comme distributeur des produits A dans le pays Z.

  "Si B et C, ou cette autre société, n'étaient pas d'accord sur l'ensemble des conditions et modalités d'un contrat de distribution, B aurait alors la liberté de proposer un tel contrat à toute autre personne, entreprise ou société, à condition cependant que B ne propose pas par la suite à cette personne, entreprise ou société, des clauses ou conditions plus favorables que celles offertes à C, ou toute autre société, qui aurait le droit d'agir comme distributeur des produits A dans les pays Z . . ."
- "Au cas où la société émettrait plus tard d'autres emprunts en Suisse, elle donnerait aux banques un droit de préférence, à conditions égales, pour la prise ferme de ces emprunts."

III. POST-CONTRACTUAL OBLIGATIONS: COMMON PROBLEMS

The above examples serve to demonstrate how frequently clauses governing post-contractual obligations are used and how diverse such clauses can be. A contract is rarely extinguished completely as a result of the performance of its main object, the expiry of a term or for any other reason. The parties often remain bound by certain residual obligations, either to wind up their contractual history, or, more characteristically, to prolong into the future certain obligations.

A number of such clauses, as we have seen, would benefit from individual, in-depth analysis. However, that is not our purpose. Our objective here is to attempt to uncover some of the problems common to post-contractual obligations.

The subject had scarcely been considered in the past. Mr. Le Stanc's interesting study on post-contractual liability, published as early as 1978 should be mentioned.[16] The author makes a distinction between the survival of the contract, where certain obligations are prolonged beyond the apparent term of the agreement, and where other obligations take effect,

[16] Chr. Le Stanc. Existe-t-il une responsabilité postcontractuelle? *Jur. Cl. Pér.*, éd. *comm. et ind.*, 1978, No. 12 735. See also Ch. Del Marmol, Réflexions sur l'utilisation des techniques contractuelles dans la vie des affaires. *Journ. Trib. (Belgium)*, 1973, p. 72. Since the first publication of this study, the matter has been dealt with by, among others, G. Carle, Les obligations postcontractuelles, in *La fin du contrat*, Jeune Barreau de Bruxelles, (ed.), 1993, pp. 257–285, and analyzed in a systematic way by J.M. Mousseron, *Technique contractuelle*, Paris, 2nd ed., 1999, No. 1785–1818.

and the memory of the contract, where the conditions governing liability in tort are affected by the prior existence of a contract between the parties concerned (for example, the assessment of whether there has been unfair competition between an employee and his employer, aside from any covenant in restraint of competition). It is mainly considerations relating to the survival of the contract that coincide with the subject matter of this chapter.

The discussions of the Working Group highlighted a series of questions arising out of the phenomenon of post-contractual obligations. Do such obligations exist in the absence of an express clause? What are the best ways to state such obligations in the contract? Are clauses prolonging certain effects of the contract always lawful? What are the penalties in cases of non-performance? Does maintaining certain specific obligations entail the parallel survival of certain general clauses of the contract? How long do such post-contractual obligations subsist, especially in cases where there has been a change in circumstances? These are the questions that will be looked at one by one.

A. Express Clauses and Implicit Obligations

The title of this report intentionally refers to post-contractual obligations and not post-contractual clauses. Although the study has been principally based on clauses taken from actual contracts, the subject needs to be considered in a broader context. Some of the clauses examined create obligations that would not exist without those clauses. Often, however, the stipulations of the contract merely govern, in accordance with the wishes of the parties, rights and obligations that already existed implicitly.

Indeed, the phenomenon of post-contractual obligations is not unknown to legal systems, even if legal theory has hardly acknowledged its existence.

In certain cases, the law itself determines these obligations. Most legal systems make specific provision to cover a seller's guarantee against defective goods, or a manufacturer or construction company's guarantee with respect to defects in construction.[17] Various legal systems, likewise, lay down confidentiality obligations.[18] And in such cases, they outlive the contract aside from any express provision.

Sometimes the law is silent on the point but case law establishes the survival of certain obligations on various bases, such as a broad interpreta-

[17] See for example Articles 1641 to 1649, 1792 and 2270 of the Code Napoléon.

[18] See for example Article 321a of the Swiss Code of Obligations, in relation to the employment contracts.

tion of a guarantee obligation, or the principle that contracts should be performed in good faith. Here, for example, we would refer the reader to French case law relating to the return of stocks on expiry of a concession contract[19] or a German decision that holds that an erstwhile landlord was under the obligation to forward the post of his former tenant, after the lease had expired.[20] Likewise, under English law, the case law makes it unlawful for the vendor of a business to canvass former customers or to use its old business name, even in the absence of any express clause to that effect.[21]

An interesting case was submitted to the *Cour du Travail* in Liège. An employer brought proceedings against a former employee for an act of unfair competition carried out after expiry of the contract, in absence of an express covenant. The act still had to constitute a breach of contract for the employment tribunal to have jurisdiction. This was the tribunal's opinion:

> ". . . si certains griefs reprochés (au défendeur) ont été commis après la cessation du contrat, la contestation soulevée reste néanmoins relative à un contrat de travail; le fait que la relation contractuelle doit être la cause directe du litige, n'empêche que la compétence s'étende même à des litiges postérieurs à la cessation de la relation contractuelle mais qui, comme en l'occurrence où il s'agit d'une action en responsibilité contractuelle du travailleur, en sont la suite nécessaire (A. Fettweiss, La compétence, Larcier, 1971, no.34, p.202); . . . la cessation d'un contrat de travail n'entraine pas la disparition de toutes les obligations contractuelles; . . . survivent, même après la rupture des relations contractuelles, certaines obligations accessoires, telles les obligations de fidelité et d'exécution de bonne foi dont la violation engage la responsibilité contractuelle de ceux à qui elles incombent."[22]

Where certain post-contractual obligations are governed by statute or recognized by the courts, express clauses have the advantage of substituting the parties' chosen solutions for those of the ordinary law. The problem of lawfulness, which we shall discuss later, is a separate one. But the preceding reflections give rise to our first piece of advice for negotiators. The post-contractual aspects, which may need an express provision, should be examined carefully in the light of the applicable regime, in accordance with the law of the contract in the absence of any clause.

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[19] See Chr. Le Stanc, *op. cit.*, No. 32, and the references cited.

[20] R.G.Z. 161,338.

[21] *Labouchère v. Dawson* (1872), L.R. 13 Eq. 322. For the case of a former employer's trade secrets, see *Faccenda v. Fowler, The Times*, November 16, 1983.

[22] Cour Trav. Liège, October 27, 1983, unreported.

In order to be fully effective, a contractual provision governing an obligation must be based on a thorough knowledge of the ordinary law from which it derogates.

B. Specific Clauses, Enumeration or General Formula?

Clauses quoted above deal with specific obligations: undertakings related to stocks, work in progress, restraint of competition, confidentiality, warranties, etc. This case-by-case approach can lead to contracts containing scattered clauses providing for post-contractual obligations.

Negotiators are sometimes aware of the phenomenon as a whole. They may then choose to deal with it in a single provision. A first method is to resort to an enumeration of obligations meant to survive the contract. Here are two examples:

- "Art. 40.7. Survival. All rights and obligations of the Contract with the exception of GC 5.3., 7.6.(b), 9.11., 9.12., 13.6., 23.2c), 25.13., 25.14., 32, 34.3., 35.4., 36, 37, 39 and 40 and SC 4 (hereinafter the "*surviving provisions*". . .) and without prejudice to the right to settle any dispute in accordance with all the provisions of the Contract in the frame of GC 36, shall expire upon the end of the Defects Liability Period . . . or earlier in case of termination of the Contract, unless provided otherwise in the Contract."
- "It is expressly understood and agreed that the rights and obligations under Sections 3, 4, 5, 7, 8, 9, 11 and 15 hereof, shall survive any termination of this Agreement, except that in the event of termination pursuant to Subsection 12.3, the rights of the breaching or defaulting party shall not survive such termination."

The positive drafting of the latter clause is certainly preferable to the rather confused negative approach of the former. The reader will also notice that the survival of certain rights has a unilateral character in the second clause, to the detriment of the party whose default caused the contract to be terminated.

The danger of any enumeration is the risk of omission. Another approach is to resort to a general formula. This is attempted by the following clause:

> "Notwithstanding any termination or expiration of this Agreement, it is agreed that those rights and obligations, limitation of liabilities and release from liability, which by their nature are intended to survive, shall survive and accrued rights of action under any provision shall not be prejudiced."

The problem is now that such a formula can lead to immense difficulties of interpretation. What are the obligations the "nature" of which is to survive the contract? Some answers may come to the mind, but many of those obligations will be open to debate.

A compromise solution could be to combine a general formula with an enumeration of examples. The above clause already referred to limitation of liability provisions. The following one is somewhat more explicit:

> "Cancellation, expiration or earlier termination of this Agreement shall not relieve Parties of obligations that by their nature should survive such cancellation, expiration or earlier termination, including, without limitation, warranties, remedies, promises of indemnity and confidentiality."

The method still appears to be risky, due to the lack of precise terminology in the enumeration.

The marked particularity of post-contractual obligations, which may call for rather elaborate specific provisions, suggests prudence with regard to any attempts to bundle them.

C. Problems of Lawfulness

Specific problems of lawfulness arise when certain clauses define post-contractual obligations. Such clauses are clearly invalid when they are intended to derogate from binding legislation or are against public policy. They may also contravene certain general principles.

In most legal systems, covenants in restraint of competition are valid only if they have certain geographical and temporal limitations.[23] There is a risk of breaching the principle of freedom to pursue a trade.

Restrictions on freedom of contract under competition law in the field of technology transfer contracts also arise. Certain contractual obligations are lawful only during the period of validity of the intellectual property rights to which they refer. The contract cannot provide for covenants going beyond that time period; if they do, the obligation becomes unlawful.[24]

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[23] See for example, Y. Serra, *La non-concurrence en matière commerciale, sociale et civile*, Paris, 1991, 337 pp.; H. De Page, *Traité élémentaire de droit civil belge*, II, No. 91; compare for English law, Cheshire, Fifoot & Furmston's *Law of Contract*, 13rd ed., 1996, pp. 411–439.

[24] See the Regulation of January 31, 1996 of the Commission on the application of Article 85(3) of the Treaty to certain categories of patent licensing agreements, more specially Art. 1, 2° (O.J.E.C., L. 31/2, February 9, 1996).

D. Penalties

What penalties attach to non-performance of clauses laying down post-contractual obligations?

If nothing has been expressly provided, the party to whom the obligations are owed does not have very many remedies. There are naturally the various remedies of specific performance or damages that may be available under the applicable law. However, if the contract has essentially been performed, the mechanism of contractual liability is partially dismantled and certain defenses may no longer be available. The right to withhold performance, for example, is no longer available if the contracting party alleging the breach is itself no longer bound by corresponding obligations, and this is often the case.[25] Termination of the contract for non-performance, where this is in the discretion of the court (see Article 1184 of the French Civil Code), may be refused if it is requested merely in respect of a breach of a post-contractual obligation, where the main object of the contract has been correctly performed.[26]

It is prudent therefore, when drafting such a clause, to consider whether it is possible to provide for stronger sanctions, for example, an appropriate penalty clause.[27] Negotiators too rarely give consideration to this; the very great majority of the clauses examined by the group did not stipulate any specific penalty.

E. Parallel Survival of the General Clauses of the Contract?

Where the contract is essentially at an end but the parties remain bound by a post-contractual clause, perhaps a guarantee obligation or a covenant of confidentiality. Does that clause truly remain isolated? Do certain general clauses of the contract not also survive?

Let us suppose that the contract provided that disputes were to be settled by arbitration, or that the courts with jurisdiction to hear any disputes were those of a certain town, or that the applicable law should be French law or that a detailed clause was to provide what action to take in respect

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[25] Where that right may be exercised, it is likely to be of very little use. Thus, if the seller of a machine fails in its obligation to provide the promised spare parts, the buyer will not be obliged to pay for them; but the inadequacy of this remedy is all too obvious.

[26] In some cases, penalties of a different nature may be considered. Thus, the revelation of manufacturing secrets by a former employee may constitute a criminal offense (see for example Article 309 of the Belgian Criminal Code). Sometimes, it is possible to apply to the courts for an order for penalty payments ("astreinte"), where allowed under the applicable law.

[27] On penalty clauses, see *supra*, Chapter 6.

of the consequences of a *force majeure* event or hardship. Do such provisions lose all effect once the contract has essentially been performed? Or, on the contrary, may they still be invoked in cases of difficulty with the performance of any "post-contractual" obligations?

At this point, no doubt, the drafting of these clauses would be scrutinized. The way in which they were worded may disclose a certain degree of generality sufficient for them to apply to all obligations arising from the contract, whensoever they were to be performed. Difficulties may nonetheless occur if those drafting these clauses did not bear in mind situations where post-contractual obligations arise: the re-balancing of the positions of the parties provided for by a hardship clause, for example, is meaningless if the upheaval in circumstances henceforth affects only a unilateral obligation.

In exceptional cases, the Working Group encountered stipulations expressly providing for the survival of certain general clauses. Thus, an arbitration clause finished with the following provision:

> "10.c. Cette clause survie à la resolution du contrat dans la mesure où il y a matière qu'on puisse déférer à l'arbitrage."

That specification is a useful one. However, it creates the risk of a contrary inference being drawn as to other general clauses that do not contain the same specific point.

The issue is covered by three international instruments, regarding termination of the contract.

Article 81,1° of the Vienna Convention of International Sales of Goods provides that "Avoidance does not affect any provision of the contract for the settlement of disputes or any other provision of the contract governing the rights and obligations of the parties consequent upon the avoidance of the contract." Such latter type of provisions may include certain clauses concerning consequences of non-performance, such as liquidated damages and exemption clauses, subject to verifying their application in case of termination.[28]

According to Article 7.3.5, 3° of the Unidroit Principles on International Commercial Contracts, "Termination does not effect any provision of the contract for the settlement of disputes or any other term of the contract which is to operate even after termination." The commentary to this provision gives an example: a confidentiality undertaking concerning infor-

[28] Cf. D. Tallon, Effects of Avoidance, in C.J. Bianca & M.J. Bonell, *Commentary on the International Sales Law*, 1987, pp. 603–604.

mation needed to produce machinery. An analogous provision appears in Article 9.305(2) of the Principles of European Contract Law.

Similarly, the new Chinese law on contracts, of March 15, 1999, provides that termination of the rights and obligations arising out of a contract does not affect clauses concerning dispute resolution (Article 98). An analogous rule is expressed about confidentiality undertakings, among others (Article 92).

F. Duration and Change in Circumstances

(a) Although various obligations survive the contract, that survival is not eternal.

The obligations relating to liquidation of the past are often to be performed immediately. Documents and advertising materials, for example, must be returned without delay. Sometimes, however, a short time limit is provided, and we have seen illustrations of this in cases of sale, or re-purchase of stocks and where the right to commission payments on earlier orders subsist temporarily.

The problem is very different where obligations, which extend the contract into the future, are concerned. By definition, these obligations are for a certain duration. But what should that duration be?

Most often, a time period is provided. Sometimes this affects the very lawfulness of the clause: we have seen this in relation to covenants not to compete, and also in clauses providing a right to intellectual property for a limited period. We have also seen express time limits in clauses covering guarantee obligations, in particular in relation to spare parts and the retention of specialized personnel.

In other cases, however, the drafters of clauses do not, on purpose or otherwise, lay down any time period. We have found examples in several of the confidentiality clauses cited above, as well as in examples of clauses of first refusal. What is then the duration of these undertakings? Sometimes, an answer is found in the law itself. Thus, Article 2596 of the Italian Civil Code provides a limit of five years maximum for covenants not to compete. In other cases, the case law maintains that the obligation must exist for a "reasonable" time. Otherwise, reference must be made to principles that may be formulated within the applicable law as to undertakings for an unspecified time period. These undertakings may, *inter alia*, be coupled with the option of unilateral termination.[29] But that solution, designed for

[29] See, in French law, J. Ghestin, Chr. Jamin & M. Billiau, *Traité de droit civil, Les effets du contrat*, Paris, 2nd ed., 1994, pp. 278–279.

contracts of indeterminate length, is not always suitable for post-contractual obligations: it is difficult to conceive of unilateral termination of an obligation of confidentiality.

(b) When a clause survives the contract until some far off date or for an indeterminate period, what would be the effect of a change in the circumstances out of which it arose? An obligation, which is thus prolonged on the coat-tails of a contract, seems particularly vulnerable to such changes.

For example, a covenant not to compete binds a former contracting party for five years. During that period, the enterprise to whom the obligation is owed disappears from the market. Must the party owing the obligation still comply? The problem is a delicate one because the party to whom the obligation is owed does not disappear legally at the time when the business closes its doors. As a natural person, the party to whom the obligation is owed survives with its rights and, in time, transmits them to its successors. As a legal person, the business survives for the period of its winding up and its rights may be passed on to another firm. That does not detract from the fact that if the economic activity ceases to be carried out, the obligation not to compete no longer makes sense. Here, we run into the difficult problem of how hardship is dealt with in the different legal systems.[30] At the time of drafting the clause, it would, of course, be possible to provide for the covenant not to compete to lapse when the enterprise to whom the obligation is owed ceases all relevant activities.

Analogous problems can arise with other obligations and other changes of circumstances. For example, what would be the fate of a confidentiality obligation if the secret, which it protected, entered the public domain? Must an obligation of first refusal always be abided by if the business to whom the obligation is owed comes under the control of a competing group?

(c) One other situation deserves mention. A contract stipulates that various obligations are to survive it. Before arriving at its normal term, however, the contract gives rise to a dispute between the parties, at the end of which the contract is terminated. Does that termination extinguish the obligations that should have survived? In certain cases, the question may be of consequence. Before termination, the parties may, for example, have communicated confidential information to each other, and the secrecy clause still serves a purpose, even if the contract has ended without having been correctly performed.[31] A wise advocate would ask the court to find that termination had not extinguished such covenants. The solution could,

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[30] See *supra*, Chapter 9, and the references quoted in note 1.

[31] Analogous problems arise when a contract is annulled.

however, depend on the circumstances: it would be difficult to conceive of the survival of a covenant not to compete that benefited the party responsible for the breach.

IV. CONCLUSION

Post-contractual obligations constitute too disparate a group to allow a much more detailed survey, but they deserve to be highlighted. They enable to re-consider "downstream" and modify received wisdom regarding the length of contracts in the same way as the study of letters of intent opened re-consideration of this problem "upstream." The few preceding reflections should also draw the attention of negotiators of contracts to a certain number of difficulties that are likely to be encountered, and that may be overcome or reduced by appropriate drafting of the relevant clauses.

FINAL OBSERVATIONS

Thirteen aspects of the law and practice of international contracts have been presented; they certainly do not exhaust the matter. Many other clauses would deserve to be examined. In each chapter, the analyses and syntheses, which followed the descriptive parts, could be developed in considerably more detail.

Enough has been said, however, to reach certain conclusions. On the one hand, studying the practice of international contracts can greatly contribute to the general theory of contracts. On the other hand, the work of the Group permits us to reveal and stress significant characteristics of such practice.

I. A RICHER AND MORE DYNAMIC VIEW OF CONTRACTS

As seen in the light of actual practice, the reality of contract is much richer and much more dynamic than the image given by traditional presentations.

A. Enrichment of Traditional Legal Analysis

In the first place, the study of international contracts considerably enriches traditional legal analysis.

At the stage of contract formation, the review of letters of intent revealed the existence of a vast set of problems previously ignored by the theory of pre-contractual negotiations. As soon as negotiations reach some amplitude, the parties often feel the need to organize their various aspects into a series of agreements (venue and frequency of meetings, composition of the delegations, working language, allocation of costs, exclusivity, confidentiality, etc.). Once the discussions have started, the gradually attained results are registered in successive documents, which become more and more elaborate; such documents should not be confused with the future contract, but they may bind the parties not to re-open discussions on points already agreed upon, and to continue negotiations in good faith.

The existence of recitals is not unknown in the *common law*, where it has generated some case law, but they are practically unheard of in civilian theory of contracts. However, it appears that a large proportion of contracts—the majority of international contracts—begins with recitals where

the parties make a series of statements. The legal effect of such preliminary statements cannot be underestimated; at the least, recitals may play a decisive part in interpreting the contract. But they may also affect the rules concerning reality of consent, the determination of the basis of the contract, the intensity of the respective commitments, the role of pre-contractual documents or the links with other contracts, and sometimes they may, by themselves, create fully effective obligations.

As to the interpretation of international contracts, the practice reveals that the parties do not refer only to the principles and traditions of the applicable law, but that they also add ingenious and sometimes controversial solutions. Thus, for reasons of contract management and evidence, a clear tendency is apparent towards some formalization of international contractual practice. Examples are provided by definitions, titles and entire agreement clauses. Still, when the contract is executed, some clauses aim at protecting the formal document against the risk of oral modifications or later conduct that would be contrary to the written stipulations. NOM (no oral modification) and non-renunciation clauses are expressions of this development. In all cases, drafters of international contracts are motivated by the concern to minimize uncertainties resulting from the applicable law and the interpretation by the judge or arbitrator. In this matter, freedom of contract serves not only to determine the contents of the parties' rights and obligations, but also their scope.

Legal systems have often paid attention to the fact that a certain contractual obligation may be binding in various degrees. French law, for instance, distinguishes between *obligations de moyens* and *obligations de résultat*. This matter catches the attention of drafters of international contracts, who resort to different expressions with variable content to characterize the parties' obligations: to exert one's *best efforts*, act with all *due diligence*, perform with *reasonable* care or in conformity with *industry standards*. Apart from the delicate problems of interpretation caused by such formulae, their analysis invites reflection on the notion of contractual obligation, the intensity of which depends on the nature of the commitments undertaken by the parties.

Confidentiality clauses offer a perfect example of the level of sophistication careful negotiating can reach. The most elaborate clauses take great care to describe the object of confidentiality, the types of information that can be excepted, the persons with whom the information may be shared, the intensity of the obligation, the precautionary measures to be taken, the duration of the undertaking and the remedies in case of breach. Analyzing such clauses gives the opportunity to consider confidentiality obligations that already arise from the applicable law, delicate aspects linked to the transmission of secret information to third parties, the illegality of certain

confidentiality undertakings, the conflicts that may arise between confidentiality clauses and the obligation to provide information before courts. There is some skepticism concerning the efficacy of confidentiality clauses; a secret can never be absolutely preserved, but a well-drafted clause will reduce the risks to a significant degree.

Liquidated damages clauses are well known in traditional presentations, although their legal status varies in comparative law. The main discussions concern clauses providing for excessive amounts; such clauses may then be avoided or reduced, depending on the legal system. Practice, however, reveals that liquidated damages are often stipulated at the obligor's initiative, in order to use such clauses to limit liability; this consideration casts a very different light on the clauses. On the other hand, the analysis of contractual documents gives evidence to the impressive degree of elaboration such clauses may attain: listing of penalties specific to each type of obligation, grace periods and provisions for amnesty, progressive penalty schemes, combination with other mechanisms to induce a higher quality of performance, combination with other remedies, etc.

Clauses limiting liability or exempting from liability are classic as well, but here, too, the study of the practice of international contracts reveals different new aspects. Fresh light is shed on the very notion of clauses limiting liability upon discovering the multiple ways practitioners manage to decrease the scope of their undertakings and liabilities: not only the traditional maximum amounts, but also the limitation of liability to cases of fraud and gross negligence, the softening of the intensity of obligations, the extension of causes of exoneration, the shifting of the burden of proof, the limitation of the time allowed and the imposition of particular formalities in order to file a claim, the exclusion of certain types of damages, especially of indirect and unforeseeable damages, the exclusion of joint and several obligations, the restriction of a warranty to reimbursement, replacement or repair of goods, etc. The analysis of such clauses also reveals the richness of the linking mechanisms with liability insurance coverage.

The impossibility of performing a contractual obligation does not lead to the same consequences in all legal systems; many are unfamiliar with the notion of *force majeure,* well established in French law among others. Yet, *force majeure* clauses are traditional in international contracts. Practitioners, however, have come up with a very elaborate stipulation, replete with original characteristics. The very notion of *force majeure* is often attenuated in its requirements, and the effects follow a different orientation from the classical theory. The suspensive effect is prominent, while the extinctive effect is not. The occurrence of the event constituting *force majeure* in itself can be the cause of new obligations: notification to the other party, providing evidence, efforts to overcome the obstacle, possible obligation to renegotiate the contract after a certain time.

The study of hardship clauses causes French and Belgian lawyers to remember that their respective legal systems are rather isolated on the international stage, when they reject the so-called *théorie de l'imprévision*. But this analysis of practice also finds that the solutions offered by most other legal systems in case of fundamental change of circumstances are not satisfactory for practitioners. Rather than letting a judge assess the situation and, in certain cases, terminate the contract, practitioners prefer to set up a re-negotiation procedure, put in place by well-drafted clauses. The most delicate problem is that of the possible intervention of a third party should the parties fail to agree; the great importance of that problem is gradually being acknowledged.

"English," most-favored customer and first refusal clauses shed a light on certain contemporary techniques of adapting contracts to market changes and of "fidelizing" a partner for a possible future operation. They also reveal the inventiveness of drafters when elaborating contractual clauses, and they again demonstrate the importance of the role a third party may play in the life of a contract, this time acting as the "independent controller" to whom one resorts sometimes in order to compare competing terms.

Assignment clauses do not only demonstrate the *intuitu personae* character of many international contracts; they also ensure the control of the other party's identity. They reveal the nature of the contract, and prevent that the assignment of the contract or of certain rights be subject to the assessment of a tribunal. The sophistication of such clauses enables parties to fully regulate the assignment in advance, and to determine its conditions, terms and effects. The fact that many assignment clauses provide for an exception to interdictions and restrictions in favor of assignments to affiliated companies seems to reveal that groups of companies are subject to a specific law of a private nature.

Clauses relating to the termination of international contracts cover a wide variety of situations and causes that bring the contract, or some of the obligations deriving from it, to an end. They include, on the one hand, clauses that specify the ways of implementing and the effects of mechanisms known in domestic legal systems (e.g. requirements of advance notice), and, on the other hand, provisions that attempt to specify some notion of variable content (such as that of contractual "fault"). In this respect, there is a noted tendency to make the events leading to termination of the contract more objective through their enumeration, thus largely eliminating the need for judicial interpretation.

Finally, the analysis of obligations surviving the contract was the occasion to point out another phenomenon ignored by the classical presenta-

tions of contract law. After the main obligations have been performed, a contractual relationship often persists between parties, not only to ensure that the contract is wound up, but also to prolong it in the future, in different ways: non-competition clauses, confidentiality undertakings, warranties, exclusivity clauses, etc. In itself, this reality is worthy of attention; it also reveals a series of particular problems, concerning, for instance, the validity of some clauses, the remedies still available, the possible parallel survival of the general clauses of the contract, the duration of post-contractual obligations and the effect of a change of circumstances.

B. Contracts in a Dynamic Perspective

The concrete approach of the international contracts practice also invites re-consideration of the general theory of contracts in a much more dynamic perspective.

Traditional presentations are divided into two main parts, devoted respectively to the formation and performance of the contract. In its study of contract formation, modern legal science has been especially concerned with determining the precise moment when the contract was concluded, or, more precisely, the moment when an offer can be considered accepted. The theory of contracts concluded at a distance (or generally the theory of declaration of wills *inter absentes*) is the most significant evidence of this concern for utmost accuracy in determining the moment the contract comes into existence. When the contract is concluded, it has to be performed. Legal developments are concerned with the various aspects of performance (contents and scope of obligations, good faith performance, place and time of performance, etc), as well as with the types of non-performance and the remedies available. Termination of the contract, as such, is rarely the subject of specific developments, since the problems involved are dealt with in the general framework of the study of the extinction of obligations. A contract normally comes to an end with the arrival of its termination date or when satisfactory performance of the obligations has taken place. It may also expire under other circumstances that do not correspond to its economic purpose: avoidance for initial imperfection, premature termination for breach or for impossibility of performance, etc. In all such cases, legal theory is concerned with the precise definition of the moment when the contract comes to an end: arrival of the termination date, day of the event, the declaration or the judgment causing termination, in some cases retroactivity of the extinction back to the date of conclusion, etc.

This is a brief reminder demonstrating that principles are present, with certain variations, in most legal systems, according to which a contract is considered to exist between precise temporal limits: from one certain moment until another certain moment.

Such an approach is understandable, since contract is a source of obligations and both the obligee and the obligor need to know when their rights and obligations start and when they are extinguished. A potential obligor owes nothing to the obligee before the contract is concluded. A former obligor does not owe anything any more after the contract has expired.

Reality, however, proves to be less categorical. Legal analysis had already introduced some shades of grey in the above presentation. However, the study of international contracts shows that a good many contracts, far from being precisely located between two temporal landmarks, have the characteristics of on-going processes with variable contents. Undertakings of a contractual nature may appear before the actual formation of the contract; formation and performance are not necessarily successive phases; after it has been performed, a contract often survives through various obligations.

(a) Before the formation of a contract, classical theory, with variations among the different legal systems, has often come to acknowledge cases of pre-contractual liability deriving from abusive disruption of negotiations, and it has also recognized the notion of promise of contract under its different forms. However, such developments remain relatively marginal compared to the results of our study of letters of intent, which has revealed the frequency of different types of contractual agreements preceding the conclusion of the final contract: planning of all aspects of the negotiations, agreements on the results already achieved and on the further proceedings. Arguments have surfaced in support of the idea that a contract can come into existence gradually, not instantaneously.

(b) Some of these pre-contractual documents create an extraordinary situation in comparison with classical theory: in some cases, parties agree to start performing the contract before the negotiations are complete, i.e., before the contract is concluded. The two traditional phases of formation and performance are no longer distinct. How can one analyze such a situation? Such decision can be considered as amounting to a specific type of agreement, which separates part of the future contract into a distinct earlier contract covering a more limited agenda, to which the parties already consent. However, it is also possible to see the relationship between this situation and the above considerations as to the moment of contract formation: the point of no-return having been reached, the parties consider that the contract is concluded even though the negotiations are not yet completed, and it is normal for performance to begin. The former analysis can be better reconciled more easily with the classical theory of contract formation, but is it not somewhat artificial, and should not the latter be preferred?

Once the contract is concluded, it has not always necessarily emerged from its phase of formation. The analysis of the practice of international

contracts shows the frequency with which parties resume their negotiations to complete or modify the contract during its existence.

A long-term contract is often re-negotiated in the course of its duration. An agreement to be performed over a long period of time is clearly very vulnerable to changes of circumstances, and some of the initial clauses may become inadequate. While some provisions call for automatic adaptation (e.g., indexation clauses), others provide for re-negotiation. Best known are hardship clauses, applicable in cases of fundamental changes in circumstances. *Force majeure* clauses also provide for re-negotiation procedures when the obstacle to performance persists for too long, and the suspension of obligations is no longer bearable. Re-negotiation of the contract can also happen with competing offer and most-favored customer clauses.

Such cases of contract re-negotiation appeared not only in our analyses; other studies have also pointed to the problem of gaps in a contract. Complex agreements so frequently found in contemporary practice cannot provide for everything. Gaps may sometimes result from involuntary omissions, which are understandable owing to the wide range of problems to be solved. But they may also be intentional, if the parties have decided to postpone the determination of certain elements of the contract, owing to their difficulty coupled with the parties' impatience to conclude the agreement. The contract may then provide for a clause dealing with gaps, organizing further negotiations on the points still pending and possibly the intervention of third parties (experts, arbitrators) in case the parties fail to agree. Here again, the classical theory might hesitate to recognize a so-called "contract" several clauses of which remain to be negotiated, but which the parties consider as concluded and begin to perform.

Even apart from the circumstances that have been described, performance of a complex contract may lead the parties to wish to introduce occasional amendments to their initial agreement. Certain contracts even provide for the setting of a permanent *contract management committee*, assigned to the task of making the necessary amendments to the original contract.

In all the above cases, the contract is subject to an occasional or a regular process of re-negotiation. The conclusion of the agreement did not bring the formation phase to an end. Formation continues throughout the life of the contract.

(c) Finally, the study of practice reveals that the contract does not always come to an end at a definite moment, as the classical theory generally states. In many cases, the contract survives through several obligations that will continue to bind the parties, or one of them, for a certain period.

It may be earlier obligations extending into the future, or new obligations arising out of the termination of the contract. The contract has come to an end only with regard to its main object; it stays alive through various accessory, but still very important obligations. Certain general clauses of the contract must also survive, in order to provide the post-contractual obligations with the necessary framework.

If such obligations survive, it is, of course, on the basis of the contract itself, and it is not really accurate to speak of post-contractual obligations. This reveals the insufficient approach of traditional analysis, which always places the termination of the contract at a definite historical moment. In many cases, termination of the contract occurs in two stages: first, termination of the main obligations, which can happen at a precise date, and then, termination of the surviving obligations, which can occur in a progressive manner over a relatively long period of time.

The "life" of a contract is not always inscribed between two precise dates when the contract is concluded and when it is terminated. The "birth" of a contract, as well as its "death," often take place in processes of certain durations, not in the form of punctual events. The study of the practice of international contracts consequently invites to a dynamic conception of contract law.

II. TRENDS IN INTERNATIONAL CONTRACT LAW PRACTICE

The analysis of so many contract clauses permits to draw some general conclusions as to several important features of international contract practice.

A. Developments in International Contract Law Practice

First, the preparation of this book was an occasion to re-examine certain contract practices after a hiatus of many years, the first report on hardship clauses having been written some 25 years ago. This raises the question whether contract practices have changed much over the past decades.

As it turns out the changes are neither revolutionary nor substantial. Of course, some clauses changed more than others. For instance, the term memorandum of understanding (MOU) is used much more frequently in precontractual relations than it was in 1977 when the original report on letters of intent was published.

Much more important changes have been noted in the economic activities and branches of trade where international contracts are used. To a significant extent, international contracts have moved from big industrial projects, such as construction and engineering contracts, towards complex financial and corporate transactions such as *project finance* or reorganiza-

tions and mergers and acquisitions. Technological developments have expanded business branches, such as information technology and telecommunications, creating new applications for existing contract clauses and techniques. International contract practice follows technological and economic changes.

B. Features of International Contract Law Practice

What are the features of international contract drafting, as those may be inferred from the publications of the Working Group? One might summarize these features along four lines: (1) international contract drafting practice to a certain extent is autonomous with regard to domestic law; (2) international contract practice leads to a certain standardization of contract clauses; (3) international contract drafting is law developed by practitioners responding to practical problems and needs; and (4) international contract drafting is increasingly influenced by Anglo-American drafting techniques

1. International Contract Drafting: The Paradox of Autonomy

As of the 1960s, the theory of *lex mercatoria* has been developed in France (primarily by Professor Goldman) and in Belgium by Professor Del Marmol. With regard to contract clauses and techniques, this theory emphasizes that the repetitive use of clauses leads to a spontaneous new law outside the boundaries of domestic law and is being enforced by arbitral awards.

The scope of this book does not permit elaborating on the nature and efficacy of the *lex mercatoria*.[1] Only two issues need to be mentioned in the context of these conclusions: (a) does international contract drafting practice confirm that international contracts refuse or are reluctant to be integrated into a given domestic law setting? and (b) what are the objectives of contract drafters who choose rules other than domestic law rules.

(a) The first question incited vivid debates during the meetings of the Working Group.[2] A majority of members were opposed or at least reluctant to admit that international contract drafting is developing outside domestic legal systems. This position applied to best efforts clauses, penalty and liquidated damages clauses, exemption clauses and hardship clauses.[3] Of course, there are exceptions such as State contracts where contract negotiations do not lead to a choice of domestic law, and where a compromise

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[1] See F. De Ly, *International Business Law and Lex Mercatoria*, Amsterdam, North-Holland, 1992, 361 pp.; F. De Ly, Lex Mercatoria (New Law Merchant): Globalization and International Self-Regulation, 14 *Diritto del commercio internazionale*, 2000, No. 3, pp. 555–590.

[2] See *supra*, pp. 448–449 and 491–492.

[3] See *supra*, Chapters 4, 6, 7 and 9.

is found by referring to general principles of law or principles common to the legal systems of the parties. These exceptions seem to confirm the rule that general practice refers to domestic law. Thus, international contract practice appears to debunk the hypothesis that international contract drafting practice is autonomous from domestic legal systems.

However, international contract drafting may be characterized as autonomous in relation to domestic law to the extent that practitioners develop new solutions or techniques within the limits set by domestic law. In this respect, reference may first be made to matters parties may freely dispose of. Contract law being, by and large, non-mandatory, there are no objections that practitioners use freedom of contract to create new rules. Furthermore, in international contracts, parties may use the conflict principle of party autonomy to choose a law that is favorable to the objectives they pursue and avoid a legal system frustrating these objectives. This rule is, however, subject to any international mandatory rules (*lois d'application immédiate*) applicable before a judge or arbitrator. Finally, there are also situations where parties may localize their contract within a jurisdiction with liberal rules in order to avoid contract rules of a less liberal country. Financial contracts on the international capital markets in London or New York are examples. Thus, also in contract law, there may be *regulatory competition* between different jurisdictions that may be used to advantage by international contract drafters.

(b) Autonomy in international contract drafting may be driven by different objectives. Extensive and elaborate contract drafting may be aimed at filling gaps in the domestic law applicable to the contract or to interpret the scope of any domestic law rule. Hardship clauses, severability clauses or extension and renewal clauses[4] may be cited as examples of clauses that serve these functions. In those cases, the parties intend to complement the uncertainties of domestic law with contractually enforceable provisions.

Secondly, the parties may have an interest in derogating from domestic law. To the extent that there is freedom of contract or party autonomy, any such derogation establishes that contract law rules of the applicable law do not correspond to the wishes or interests of the parties or to their respective bargaining positions and power.[5]

Finally, from a psychological and business management perspective, international contract drafting shows a desire for self-regulation and self-

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[4] See *supra*, Chapers 9 and 12 and B. Kohl, Les clauses de prolongation et de renouvellement, *I.B.L.J.*, 2002, pp. 443–460.

[5] See U. Draetta, Les clauses de force majeure et de hardship dans les contrats internationaux, *I.B.L.J.*, 2002, pp. 347–358.

management on the part of businessmen and legal practitioners. The parties want to retain control over their contract and, consequently, deal extensively with contract formation, entry into force, contents, termination and dispute settlement. This idea is clearly behind confidentiality clauses that are inspired by a desire to control the flow of confidential information.[6]

This feature affirms the fact that the parties know, or are deemed to know, better the details of their business dealings and are therefore in a better position to make decisions regarding the birth, life and death of their contract. On the other hand, it expresses a reluctance—often legitimate—that third parties such as judges, arbitrators, experts or others interfere in their business relationship while the parties may still be able to solve the issues or problems at hand.

The following developments reflect the new directions that have been noted in the previous chapters:

1. The increasing use of contractual procedures that determine the conditions under which contract clauses are to be triggered and dealt with (*contractual processualization*);[7]
2. The increasing use of contractual documents that formalize the above-mentioned contractual procedures (*contractual formalization or documentalization*) as, for instance, with regard to recitals and entire agreement clauses;[8] and
3. The increasing use of objective standards of conduct to avoid escalation of disputes (*contractual objectivation*) as has been noted in the analyses of the Working Group regarding best efforts clauses[9] and deadlock and divorce clauses in joint venture contracts.[10]

These new developments are gradually transforming the role of contract negotiators and drafters from legal technicians to managers of contract formation, performance, termination and dispute settlement.

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[6] See M. Bühler, les clauses de confidentialité dans les contrats internationaux, *I.B.L.J.*, 2002, pp. 359–387.

[7] See *supra*, Chapters 8, pp. 418–435 (*force majeure* clauses) and Chapter 9, pp. 476–486 (hardship clauses).

[8] See *supra* Chapters 2 and 3, pp. 129–150 as well as A. Farnsworth, L'interprétation des contracts internationaux et la pratique des préambules, *I.B.L.J.*, 2002, pp. 271–279.

[9] See *supra*, Chapter 4 as well as Ch. Chappuis, Les clauses de best efforts, de reasonable care et de due dilgence et les règles de l'art dans les contrats internationaux, *I.B.L.J.*, 2002, pp. 281–301.

[10] See F. De Ly, Divorce Clauses in International Joint Venture Contracts, *I.B.L.J.*, 1995, pp. 279–315.

The conclusion so far is that international contract drafting is characterized by a great deal of autonomy at different levels but still, to a large extent, anchored in a supporting domestic legal system. If this conclusion were correct, then international contract drafting would not be completely autonomous from domestic law but would have created a paradoxical autonomy.

This perspective of international contract drafters is not without some ambiguity. On the one hand, they prefer their contract to be inserted into domestic law through a choice of domestic law clause. On the other hand, international commercial arbitration remains, by and large, the preferred method of dispute settlement. International commercial arbitration has, however, been liberalized to a certain extent from domestic law, which creates tensions between the applicable law and the denationalization of arbitration.[11]

2. *International Contract Drafting: Standardized Law?*

Contract clauses may be copied from one contract to another. This process has been facilitated with the massive introduction some 20 years ago of word processing software. More recently, optical reading devices and the Internet have contributed to easy reproduction of texts. Has international contract drafting thus become standardized law using boilerplate clauses,[12] or has it remained, by and large, a practice based on tailor-made *contracts* drafted for each situation?

There is no clear-cut answer to this question, since some clauses are found in most contracts (e.g., some interpretation clauses such as entire agreement clauses, no oral modification clauses, language clauses, non-waiver clauses, severability clauses as well as assignment clauses, choice of law clauses, arbitration clauses) showing a lot of uniformity. But even in these clauses, there are differences related to the specific facts of the case or the respective bargaining positions of the parties. Also, an increasing degree of sophistication is used in the drafting of these clauses, especially in arbitration clauses. The general conclusion is that even for these clauses, international contract drafting—notwithstanding some uniformity—may not be reduced to boilerplate and that standardization has only taken place to a certain extent. In any event, international contract

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[11] In this respect, one may refer to situations where the parties could not agree on the law applicable to their contract and either did not insert a choice of law provisions or made a reference to principles of international trade law. Furthermore, the composition of the arbitral tribunal may be such that only a minority of its members have expert knowledge of the applicable law. Finally, psychological or other reasons may explain why the arbitral award hardly ever refers to the applicable law.

[12] See, for instance, R. Chistou, *Boilerplate: Practical Clauses,* London, Financial Times Law & Tax, 2nd ed., 1995, 226 pp.

drafting is not standardized law. This conclusion does not only hold true for individually negotiated contracts (*on off contracts*) but even for general conditions that pursue standardization objectives from the user's perspective but are generally not aimed at standardization involving the entire branch of trade concerned.[13]

On the other hand, there are contract clauses and techniques (e.g., letters of intent, recitals, penalty and liquidated damages clauses, exemption clauses,[14] termination clauses, confidentiality clauses, post-contractual obligations clauses) that are so intimately related to the fundamental obligations of the parties and form the hard core of the contract, that they are specifically negotiated and where scant uniformity is present. For these clauses, there is no standardized law and these clauses cannot be characterized as boilerplate. Consequently, international contract drafting hardly contributes to the formation of spontaneous law in the sense that specific and concrete rules might be derived from these clauses. However, this does not exclude that more abstract principles may be formulated on the basis of international drafting practice. For instance, the analysis of *force majeure* clauses has indicated that practice has developed a rule of suspension of contract performance in case of temporary events of *force majeure*.[15]

The nature of boilerplate clauses has sometimes been addressed during the discussions of the Working Group in the context of formulating model clauses.[16] The Group generally has been reluctant to formulate model clauses and has never embarked on such a project. Contrary to other organizations such as ICC, FIDIC, ECE, CNUDCI or the International Center for Commerce (UNCTAD/WTO) that have published model clauses, the Group has limited its work to the collection, analysis and assessment of clauses. Formulating model clauses has not been undertaken because of the diversity of factual elements and specific interests that are mostly at stake in the contracts that were researched. These reservations are, to a large extent, legitimate, but one may wonder whether for the first category of clauses mentioned above, different model clauses might not be suggested. For the second category of clauses discussed in the previous paragraph, one should perhaps at least consider drafting appropriate *checklists*.

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[13] Exception to be made for commodities markets where product homogeneity leads to standardization of contract rules.

[14] See J. Rajski, Les clauses limitatives et exonératoires de responsabilité dans les contrats internationaux, *I.B.L.J.*, 2002, pp. 321–328.

[15] See *supra*, Chapter 8, pp. 424–428.

[16] See *supra*, note 2.

By way of conclusion, one may say that there is no standardized law of international contracts and that divergence (rather than uniformity) is the rule. This implies, in practice, that each international contract may require sufficient attention as far as negotiation and drafting are concerned and that contract provisions are to be checked against the law applicable to the contract.

3. *International Contract Drafting: Practitioners' Law?*[17]

Practitioners draft international contracts corresponding to the interests they represent and to the needs of the transaction involved. This is true for *force majeure* and hardship clauses where contract drafters have sought solutions in order to avoid that contracts are terminated by the mere occurrence of an event of *force majeure* or that contracts are to be performed as agreed even when circumstances have drastically changed. This practitioners' law develops along two lines: (a) the solution of practical problems encountered in daily business life; and (b) the perspective of the private interests that the drafter is representing.

(a) In solving practical problems, drafters engage in a creative process that unfolds along non-structured lines, in sometimes chaotic fashion, and is not inspired by dogmatic conceptions. In this respect, an analogy can be made with the way lawyers and judges work, argue and reason in common law jurisdictions. Contrary to the civil law tradition, the drafting process is not guided by pre-established notions and principles but by formulating concrete and pragmatic rules aimed at solving the problems at hand. Similarly to the distinction between scholarly opinion and case law in some civil law countries, international contract practice notes the difference between contract law as it is taught at the law schools and contract law in action in the practice of international contract drafting. Hardship clauses are, for instance, the answer developed, in practice, to the strict rules of contract law regarding supervening changes in circumstances in countries such as France, Belgium and England. Letters of intent aim at solving problems regarding extensive negotiations and pre-contractual liability not dealt with in many jurisdictions.[18]

These different forms of contractual engineering contribute to the formation of new legal principles that are essential to know as well as understand the mechanics of international contracts. The spontaneous and gradual nature of these rules has the disadvantage of opacity. It is regrettable that scant efforts are made to increase transparency notwithstanding

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[17] See G. Langenfeld, *Vertragsgestaltung: Methode, Verfahren, Vertragstypen,* Munich, Beck, 2nd ed., 1997, 197 pp.

[18] See *supra,* Chapter 1 as well as J. Schmidt-Szalewski, Les lettres d'intention dans la pratique internationale, *I.B.L.J.*, 2002, pp. 257–270.

its manifest importance in practice. The added value of the activities and reports of the Working Group may precisely be that they contribute to transparency and analysis of international contract drafting practice. On the other hand, the creative work of practitioners in the process of drafting international contracts does not intend to create new legal rules of a general nature but rather to address concrete problems. The frequent presence of contract clauses, in practice, does not have quasi-legislative ambitions but may have indirect effects to the extent that judges and, more importantly, arbitrators may take these into account by means of open-ended standards of adjudication of the applicable law (e.g., good faith and fair dealing or best efforts) or through conflict of laws methods (e.g., conflict rules the arbitrators deem appropriate or the better law approach).

The importance of the creative processes of international contract drafting practice also has relevance for contract law teaching and research. It is regrettable that contract drafting courses are, by and large, absent from law school curricula and that scant books are available on the subject.[19] National legislatures, domestic courts and international conventions hardly take drafting practice into account. For instance, the Convention on the International Sale of Goods (CISG) is primarily based on traditional notions of offer and acceptance and does not address issues of pre-contractual liability. Neither does it tackle sales concluded in the context of framework contracts nor long-term supply contracts where issues of hardship may arise. Fortunately, Principles such as the Unidroit Principles and the Principles of European Contract Law (Lando Commission)[20] have paid more attention to contract practice, namely to entire agreement clauses (Unidroit, Article 2.1.17; PECL, Article 2:105).

(b) The second issue regarding the role of practitioners in creating new contractual clauses and developing new contractual techniques concerns the legitimacy of these efforts. This issue is related to the autonomy question discussed in Section II.B.1: the formal legitimacy of this law-mak-

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[19] Most books refer to domestic contracts, see J.M. Mousseron, *Technique contractuelle*, Paris, Francis Lefebvre, 2nd ed., 1999, 792 pp.; R. Christou, *Drafting Commercial Agreements*, London, Sweet & Maxwell, 2nd ed., 1998, 749 pp. For international contracts, one may cite some works that are aimed at practitioners (*Lamy Contrats Internationaux* H. Lesguillons (ed.) 7 Vols., *Joly Contrats Internationaux* V. Heuzé (ed.) 7 Vols. *International Business Transactions*, D. Campbell (ed.) 3 Vols., The Hague, Kluwer Law International, A.H. Kritzer, *International Contract Manual*, The Hague, Kluwer Law International, Münchener Vertragshandbuch, *Tome 3/2, Internationales Wirtschaftsrecht*, Munich, Beck, 1997, 1303 pp.); F. Bortolotti, *Diritto dei contratti internazionali*, Padova, Cedam, 1998, 673 pp.; M. Bianchi, *I contratti internazionali*, Milan, Il sole 24 ore, 3 Vols., 1998–1999, 181, 313 and 261 pp.

[20] *Unidroit Principles on International Commercial Contracts*, Rome, Unidroit, 2004; *Principles of European Contract Law, Parts I and II*, Commission of European Contract Law, O. Lando, & H. Beale (eds.), The Hague, Kluwer Law International, 2000, 561 pp.

ing process is found in freedom of contract and party autonomy to the extent that these are recognized in the law applicable to the contract.

By way of conclusion, international contract drafting practice confirms the hypothesis that practitioners contribute gradually, and at different levels, to the formation of legal rules or principles that are substantive rules of contract law enforced by judges and arbitrators within the boundaries set by the applicable domestic law.[21]

4. *International Contract Drafting: Of Anglo-American Origin?*

During the past 25 years, the Working Group has witnessed the gradually growing importance of the English language as the contract language and of Anglo-American techniques and contract drafting styles.[22] This tendency raises the question whether international contract drafting law and practice has not become heavily influenced by Anglo-American law and practice.[23] Some see in this tendency a new stage of development in the *lex mercatoria* now dominated by Anglo-American law. Thus, the *lex mercatoria* would be developing not as a national law but as uniform contract law dominated by Anglo-American law and by the big English and American law firms.[24]

Before analyzing this question, one needs to identify the underlying causes of such developments.[25] First, there is the undisputed Anglo-American economic dominance not put in question after the fall of the Berlin Wall, the shift in Central and Eastern Europe to market economies and the demise of the Soviet Union. Also, in international economic and financial dealings, institutions such as the World Bank and the Inter-

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[21] See, in relation to penalty clauses in arbitration, B. Cremades, Les dommages-intérêts conventionnels prévus en cas de rupture de contrat, les clauses pénales et les dommages-intérêts à caractère répressif dans les contrats internationaux, *I.B.L.J.*, 2002, pp. 329–345.

[22] Regarding *anticipatory breach of contract*, see M. Vanwijck-Alexandre, Les clauses mettant fin au contrat et les clause survivant à la fin du contrat, Première partie, *I.B.L.J.*, 2002, pp. 407–442.

[23] See *L'américanisation du droit*, 45 Arch. Phil. Dr., Paris, Dalloz, 2001, 399 pp.; W. Wiegand, The reception of American Law in Europe, *Am. J. Comp. L.* 1991, 229; W. Wiegand, Amerikanisierung des Rechts, insbesondere des Bank- und Wirtschaftsrechts, in Corporations, Capital Markets and Business in the Law, *Festschrift R. Buxbaum*, The Hague, Kluwer Law International, 2000, pp. 601–615.

[24] M. Shapiro, Globalization of the Freedom of Contract, in *The State and Freedom of Contract*, N. Scheiber (ed.), Stanford, Stanford University Press, 1998, pp. 268–298; S. Schuit, *De onstuitbare opmars van het Anglo-Amerikaanse recht*, Contracteren, 2001, pp. 42–44.

[25] Compare E.A. Farnsworth, *L'américanisation du droit—Mythes ou réalités*, Arch. Phil. Dr., 2001, pp. 21–28.

national Monetary Fund impose liberalization measures on international trade and influence economic policy in developing countries. Economic globalization (as well as ideological, and to a certain extent, cultural) has not found countervailing forces in a divided Europe or in Asia. Although economic globalization has not found its equivalent at the political level, where there are no global law-making institutions that would threaten national sovereignty,[26] this is hardly relevant for contract law that, for commercial transactions, is, by and large, non-mandatory. Legal globalization for commercial transactions, thus, follows economic rather than political processes. This is especially true for the international capital markets where uniform practices prevail. These global processes, in the absence of alternatives, are governed by Anglo-American legal rules. Even in less global markets, the dominance of Anglo-American law is felt. The reasons are economic and psychological and are validated by the absence of alternatives. As to the economic benefits, standardization of international contracts in the English language and in accordance with Anglo-American models and techniques reduce transaction costs for companies. In addition, there are psychological advantages. A common language and drafting style contribute to the creation of a common platform for linguistic and legal communication for practitioners coming from different jurisdictions, who attempt to cross language and legal culture barriers. The liberalization of the legal profession at regional and worldwide levels has also contributed to these developments. The economic factors driving these changes and leading to more standardization based on the Anglo-American model, of course, also entail disadvantages in terms of loss of linguistic, cultural and legal diversity.

These observations have been confirmed, to a certain extent, by legal sociologists influenced by the sociological theories of Pierre Bourdieu, who emphasizes that—primarily in international commercial arbitration—transnational elite lawyers push legal globalization inspired by conviction and/or self-interest.[27] Their expertise gives them a competitive edge and relegates others to a secondary role.

Whether one agrees or not with these findings, the question of Anglo-American influence has been raised, and forces us to consider the impact of the English language and of Anglo-American contract drafting models and techniques.

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[26] J. Wiener, *Globalization and the Harmonization of Law*, London, Pinter, 1999, pp. 184–198.

[27] Y. Dezalay & B. Garth, *Dealing in Virtue, International Commercial Arbitration and the Construction of a Transnational Legal Order*, Chicago, University of Chicago Press, 1996, 343 pp.

The answer is probably not definitive. Recent economic literature suggests that there is no globalization but rather tendencies towards deregulation and economic integration limited to the triangle North America, Europe and the Far East. Furthermore, there are different levels of integration depending on the economic sectors involved. International capital markets or the markets for corporate control are much more sensitive to Anglo-American standardization than less integrated markets.

The Anglo-American influence on the international contract drafting scene can further be explained by factors related to the above-mentioned structure and approach of the common law. Maybe the common law is better at problem solving, and is thus more client and market oriented, while the civil law is better at conceptualization. A legal sociologist, Volkmar Gessner, has asked the provocative question whether Continental European legal education is not doomed to produce global losers, since it produces graduates incapable of solving practical legal problems.[28] Paraphrasing Gessner, the shocking question arises whether lawyers from civil law jurisdictions do not risk losing the competitive battle for transborder legal services lacking the tools to provide the services clients need and that their common law counter-parts can offer.

From a legal perspective, this does not imply that common law solutions are superior to civilian solutions. Some common law rules are indeed subject to criticism as noted in relation to the English approach to contract interpretation. The literal English interpretation tradition is the exception in comparative law and may have practical disadvantages with its demand for excessive detail, which is not necessary in a context where English law is not involved.

On the other hand, one also sees common law countries develop in the direction of more rationalization and, thus, converge with civil law approaches. Recently an American author has noted that "the relics of the old English common law cannot be defended either rationally or pragmatically" and advocated that in order to build "a coherent private law," efforts towards greater systematization already proposed by Blackstone and 19th-century authors and inspired by civil law traditions, should be pursued.[29] Major developments in uniform law such as CISG, the Unidroit Principles and the PECL all have taken place in the form of codification along structured lines following the civil law codification tradition, notwithstanding numerous common law contributions.

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[28] V. Gessner, *Globalization and Legal Certainty, in Emerging Legal Certainty: Empirical Studies on the Globalization of Law*, V. Gessner, & A. Cem Budak (eds.), Aldershot, Dartmouth, 1998, pp. 446–447.

[29] J. Gordley, The common law in the twentieth century: some unfinished business, 88 *Calif. Law Rev.*, 2000, pp. 1815–1875.

With some reservations and exceptions, one might say—whether one likes or dislikes that conclusion—that the battle for the *lingua franca* of international business transactions has been won by the English language and the consequences are clear: a good, if not excellent, knowledge of that language is essential for international contract drafters. Legal education and continuing legal education should adjust accordingly.

As to contract clauses and techniques, the influence of Anglo-American law cannot be denied, but integration in civil law contexts must be considered cautiously. Contract drafters must check the applicable law and look for compatibility of concepts and structures. Some inspiration may come from the recent achievements of uniform law which bridge common and civil law divides. Thus, alternatives may be considered and developed that may be better suited to the needs of international commerce.

Finally, the real problem is not that one legal culture should prevail over another, but that an open-minded approach is required to develop solutions tailored to the demands of international commerce that need not necessarily be based on any domestic legal system. Consequently, there is no need for a national, European or other answer to the Anglo-American challenge but a search for new and better solutions. The years to come may confirm the relevance of national law for drafting international commercial contracts but also the useful and increasing development of new and workable solutions based on uniform law or on different national legal systems.

III. AN ON-GOING PROGRESS

Thirteen chapters have attempted to describe and analyze the drafting of international contracts in practice. Twenty-five years (1975–2000) of meetings and discussions of the Working Group have been summarized in this volume. The project still continues and other subjects will follow.

The authors and the members of the Working Group hope that this book will contribute to a better understanding of the intricacies encountered in the practice of drafting international contracts and to the development of international contracts law.

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